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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1931

No. 582

WOOLFORD REALTY COMPANY, INC., PETITIONER,

vs.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED DECEMBER 21, 1931

CERTIORARI GRANTED JANUARY 25, 1932

(36,396)

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[Caption omitted]

TRANSCRIPT OF RECORD.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

WOOLFORD REALTY COMPANY, INC.,
Appellant,
versus
At Law.

J. T. ROSE, UNITED STATES COLLECTOR OF INTERNAL REVENUE, FOR THE DISTRICT OF GEORGIA,
Appellee.

AN APPEAL from the District Court of the United States for the Northern District of Georgia, Atlanta Division.

Joseph B. Brennan, Esq., 920 Atlanta Trust Bldg., Atlanta, Ga.

Sutherland & Tuttle, 920 Atlanta Trust Bldg., Atlanta, Ga.

Attorneys for Appellant.

Clint W. Hager, Esq., United States Attorney, Atlanta, Ga.

C. P. Goree, Esq., Assistant United States Attorney, Atlanta, Ga.

Attorneys for Appellee.

1a

PETITION.

In the District Court of the United States for the Northern District of Georgia, Atlanta Division.

Woolford Realty Company, Inc., a Corporation,
Plaintiff,
vs. No. 1246 At Law.

J. T. Rose, United States Collector of Internal Revenue for the District of Georgia,
Defendant.

To the District Court of the United States for the Northern District of Georgia, Atlanta Division.

The petition of Woolford Realty Company, Inc., a corporation, Plaintiff, names J. T. Rose as party Defendant and respectfully shows to this Honorable Court:

I.

That plaintiff is and was at all times mentioned herein a corporation organized and existing under the laws of the State of Georgia, having its principal office and place of business in the City of Atlanta, Fulton County, Georgia, residing in and being a citizen of the Atlanta Division of the Northern District of Georgia.

II.

That defendant is a citizen of the State of Georgia and resides in the City of Atlanta in the Atlanta Division of the Northern District of Georgia, and that at the time of payment of the amounts herein sought to be recovered, and at all times since the dates of such payments, defendant has been and now is Collector of Internal Revenue of the United States for the District of Georgia, in which collection district the plaintiff resides.

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III.

That this is a suit of a civil nature, arising under the laws of the United States, providing for Internal Revenue, to-wit, the Revenue Act of June 2, 1924, Ch. 234, 43 Stat. 254 and the Revenue Act of February 26, 1926, Ch. 27, 44 Stat. 10.

IV.

That the defendant is indebted to the plaintiff in the principal sum of $5,026.22 besides interest on $1,253.10 from March 15, 1928, and on $1,253.10 from June 15, 1928, and on $2,520.02 from October 9, 1929, at the rate of 6% per annum, by reason of the facts set forth in the following paragraphs:

V.

That the plaintiff owned throughout the year 1927 ninety-six per cent of the capital stock of Piedmont Savings Company, a Georgia corporation, and said corporations were affiliated within the meaning of the Revenue Act of 1926 and were entitled, under the Revenue Act of 1926 and Regulations 69, to file a consolidated return.

VI.

That on or about March 15, 1928, plaintiff and said Piedmont Savings Company filed a consolidated corporation income tax return for the calendar year 1927 showing net taxable income to plaintiff of $37,582.63 and a loss to Piedmont Savings Company of $453.80 and a combined net taxable income to the consolidated group of $37,128.83, upon which the tax was computed to be $5,012.39, which tax was in due course assessed against plaintiff.

VII.

That the income and tax of the consolidated group computed as above stated did not take into consideration statutory net losses sustained by said Piedmont Savings Company in 1925 and 1926 amounting respectively to $43,478.25 and $410.82, or a total of $43,889.07.

VIII.

That said Piedmont Savings Company actually sustained in 1925 and 1926, respectively, as reported in its Federal income tax returns for those calendar years, statutory net losses of $43,478.25 and $410.82, or a total for the two years of $43,889.07.

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IX.

That on or about May 9, 1928, plaintiff and said Piedmont Savings Company filed an amended consolidated corporation income tax return on Form 1120 showing the same items of income and expense in exactly the same amount as shown on the original return referred to in Paragraph VI above, except that it claimed as an additional deduction from consolidated income the sum of $43,889.07, being the amount of the statutory net loss of Piedmont Savings Company for 1925 and 1926. A copy of the material portions of page 1 of said return, which are the only portions of the return here material, is attached hereto and made a part hereof, marked "Exhibit A."

X.

That an Internal Revenue agent investigated the returns of plaintiff and said Piedmont Savings Company for the calendar year 1927 in May 1929 and made certain minor adjustments, which reduced the net taxable

income of plaintiff to $36,587.62 and left the loss of said Piedmont Savings Company for the calendar year 1927 unchanged, and disallowed any deduction on account of the statutory net losses of said Piedmont Savings Company for 1925 and 1926, which resulted in a consolidated net taxable income of $36,133.82.

XI.

That the Commissioner approved the adjustments made by the Revenue Agent and denied to plaintiff and said Piedmont Savings Company the right to bring forward any part of the statutory net losses in 1925 and 1926 to be deducted from or to reduce in any way the income of the consolidated group for the calender year 1927, as computed without reference to the statutory net losses of said Piedmont Savings Company for 1925 and 1926, with the result that only $134.32 of the original assessment of $5,012.39 was abated, leaving a balance of tax due amounting to $4,878.07.

XII.

That if the deduction of the net losses sustained by said Piedmont Savings Company had been allowed by the Commissioner there would have been no net income to the consolidated group and no tax would have been due by the consolidated group for the calendar year 1927.

XIII.

That plaintiff paid to the defendant herein as Collector of Internal Revenue for the District of Georgia the following amounts of taxes and interest on the dates specified:

March	15, 1928	$1,253.10	tax
June	15, 1928	1,253.10	tax
October	9, 1929	2,371.87	tax
October	9, 1929	148.15	interest

XIV.

That on or about November 8, 1929, plaintiff filed with the defendant a claim for refund of taxes, copy of which is attached hereto and made a part hereof marked "Exhibit B."

XV.

That said claim for refund was disallowed by the Commissioner on a schedule dated December 20, 1929.

XVI.

That by reason of the overstatement of the consolidated income of plaintiff and said Piedmont Savings Company, as aforesaid, and the exaction of the tax upon said overstated income, the defendant wrongfully and illegally exacted of the plaintiff the sum of $4,878.07, corporation income tax, and interest of $148.15, none of which was legally due from the plaintiff, and defendant continues to withhold said sums from the plaintiff, although he has been requested to return said sum to the plaintiff with interest thereon.

Therefore, plaintiff prays that process issue directed to the defendant requiring him to be and appeal at the next term of this Court to answer this Petition, and further prays that it have judgment of the Court against the defendant for the sum of $5,026.22, together with interest on $1,253.10 from March 15, 1928, and on $1,253.10 from June 15, 1928, and on $2,520.02 from October 9, 1929, at the rate of 6% per annum, together with all costs of this proceeding.

Respectfully submitted,
(Sgd.) W. A. SUTHERLAND,
(Sgd.) JOSEPH B. BRENNAN,
Attorneys for Plaintiff.

Of counsel:

SUTHERLAND & TUTTLE,
Atlanta Trust Company Bldg.
Atlanta, Georgia.

Filed February 18, 1930.

6 Georgia,
Fulton County.

Personally appeared before me, the undersigned attesting officer, James E. Dickey, who, being first duly sworn, deposes and says that he is Vice-President and Secretary of the plaintiff in the foregoing suit, and that as such he is familiar with the facts stated in the foregoing Petition, and that the facts stated therein are true of his own knowledge.

(Sgd.) JAS. E. DICKEY.

Sworn to and subscribed before me this 18th day of January, 1930.

(Sgd.) J. J. SIMPSON, Jr.,
Notary Public, Ga. State at
(Seal) Large.
My commission expires July 11, 1930.

(Exhibits omitted.)

7 Summons and Marshal's Return Thereon, omitted from the printed record.

* * * * * * * *

9 DEMURRER OF DEFENDANT.

(Title Omitted.)

Now comes J. T. Rose, named as defendant in the above entitled case, and for demurrer to said petition says:

(1) Plaintiff's said petition does not state a cause of action against this defendant.

(2) It appears from the facts as stated in said petition, especially in paragraphs 7, 8, 9, and 10 thereof, that the plaintiff is not entitled to recover any sum whatever from this defendant in said suit.

Wherefore, defendant prays judgment of the Court, etc.

(Sgd.) C. P. GOREE,
Assistant U. S. Attorney and
Attorney for the Defendant.

Filed May 29, 1930.

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10 OPINION ON DEMURRER.

(Title Omitted.)

Woolford Realty Company sues to recover as an overpayment income tax paid on a consolidated return for itself and Piedmont Savings Company for the year 1927. A general demurrer is enterposed. The petition and exhibits show these facts: Piedmont Savings Company, prior to 1927, was not so affiliated with plaintiff as to permit consolidated returns. The separate returns of Piedmont Savings Company for 1925 and 1926 showed net losses. The consolidated return for 1927 showed a small net loss for the Piedmont Savings Company, which was taken off the net income shown for Woolford Realty Company in fixing the consolidated tax. By an amendment of the consolidated return there were sought to be brought forward as additional deduc-

tions the net losses of the Piedmont Savings Company for 1925 and 1926, which would have canceled the net income for 1927 of Woolford Realty Company. The correctness of the denial of these deductions is the whole question here.

Section 240 of the Revenue Act of 1926 permits affiliated corporations to make consolidated returns for "any taxable year" under regulations prescribed by the Commissioner. The Regulations 69, Section 632 and following deal with consolidated returns, but make no express provision about carrying forward previous separate net losses. Section 634, relating to changes of ownership during the year, rather indicates a purpose to exclude from the consolidated return all separate business. Section 635, relied on by plaintiff, while it requires the separate deductions for each corporation to be stated, says nothing about what they shall include. Ordinarily the deductions are the same that would be shown for each corporation on a separate return. Regulation 1622, which deals with carrying forward a net loss for deduction the following year, says "It should be noticed, however, that a net loss for a preceding year may not be considered in computing a net loss for a succeeding year." This is a fair interpretation of the language of Revenue Act of 1926, Section 206(b) on the point. Since, therefore, Piedmont Savings Company made no net income in 1927, but a net loss, this previous net loss would not be considered in a separate return. In permitting consolidated returns where one corporation substantially owns the other, Congress apparently desired to recognize that the business might all be justly considered that of the parent company and its profits and losses dealt with accordingly "for the taxable year." Laying emphasis on the quoted words, and confining the period of consolidated accounting to the period of actually affiliated business, will effectuate this intent. Regulation 634 even carries it into fractions of a year. To permit a

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money earning corporation to take credit for net losses of another corporation which it has subsequently bought would not be in line with, but antagonistic to, the intent of and the reasons for the law. Whether the net losses for 1925 and 1926 would have been available if a net income had been shown by the Piedmont Savings Company after affiliation in 1927 need not be here decided. The petition sets forth no cause of action and will be dismissed.

This November 14th, 1930.

(Sgd.) SAM'L. H. SIBLEY,
U. S. Judge.

Filed November 14, 1930.

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12 JUDGMENT.

This case came on to be heard on the 8th day of November, 1930, before the Honorable Samuel H. Sibley, United States Judge, presiding, on the Demurrer to plaintiff's petition and the Court being of the opinion that the Demurrer is well taken, it is therefore considered, ordered and adjudged by the Court that the Demurrer to Plaintiff's Petition in this case be and the same is hereby sustained in all respects and that Plaintiff's Petition be and the same is hereby dismissed. It is further considered, ordered, and adjudged by the Court that the defendant have and recover of the plaintiff $....., costs of suit.

This 22d day of November, 1930.

SAM'L. H. SIBLEY,
United States Judge.

Filed Nov. 22, 1930.

13 PETITION FOR APPEAL.

To the Honorable Samuel H. Sibley, District Judge:

The above named petitioner, Woolford Realty Company, Inc., considering itself aggrieved by the judgment made and entered on the . . day of November, 1930, in the above entitled cause, does hereby appeal from said judgment to the United States Circuit Court of Appeals for the Fifth Circuit, for the reasons specified in the assignment of errors, which is filed herewith, and it prays that this appeal may be allowed, and that citation be issued as provided by law, and that a transcript of the record, proceeding, and documents upon which said judgment was based, duly authenticated, be sent to the United States Circuit Court of Appeals for the Fifth Circuit under the rules of such Court in such cases as may be provided.

W. A. SUTHERLAND,
JOSEPH B. BRENNAN,
Attorneys for Petitioner.

Of counsel:

SUTHERLAND & TUTTLE,
Atlanta Trust Co. Bldg.
Atlanta, Georgia.

Filed Nov. 22, 1930.

14 ORDER ALLOWING APPEAL.

Upon due consideration of the foregoing petition for an appeal, it is ordered that the appeal herein be allowed as prayed for, and it is further ordered that a certified transcript of the record and all proceedings be transmitted to the Circuit Court of Appeals for the Fifth Circuit. It is further ordered that the bond on appeal be fixed at the sum of $250.00.

This 22 day of November, 1930.

SAM'L. H. SIBLEY,
United States Judge.

Filed Nov. 22, 1930.

15 ASSIGNMENT OF ERRORS.

(Title Omitted.)

Now comes the said Woolford Realty Company, Inc., plaintiff in the above entitled cause, and files the following assignment of errors, upon which it will rely in the prosecution of the appeal herewith petitioned for in said cause, from the judgment of this Court entered on the .. day of November, 1930.

1. The Court erred in sustaining defendant's general demurrer to the petition and by deciding that the facts stated in said petition were not sufficient to constitute a cause of action.

2. The Court erred in rendering judgment dismissing the petition.

Wherefore, plaintiff prays that the said judgment may be reversed and for such other and further relief as to the Court may seem just and proper.

Dated November 22, 1930.

W. A. SUTHERLAND,
JOSEPH B. BRENNAN,
Attorneys for Plaintiff.

Filed Nov. 22, 1930.

16 State of Georgia,
County of Fulton.

Know all men by these presents, that we, Woolford Realty Company, Inc., as principal, and Walter C. Hill, as surety, are held and firmly bound unto J. T. Rose, Collector of Internal Revenue, in the full and just sum of Two Hundred Fifty Dollars ($250.00) to be paid to the said J. T. Rose, Collector of Internal Revenue, his certain attorney, executors, administrators, or assigns; to which payment, well and truly to be made, we bind

ourselves and each of us, jointly and severally, and each of our heirs, executors and administrators, by these presents. Sealed with our seals and dated this 22nd day of November, 1930.

Whereas, lately at a District Court of the United States for the Northern District of Georgia, in a suit depending in said Court, between Woolford Realty Company, Inc., plaintiff, and J. T. Rose, Collector of Internal Revenue, defendant, a judgment was rendered against the said Woolford Realty Company, Inc., and the said Woolford Realty Company, Inc., has prosecuted an appeal to the Circuit Court of Appeals for the Fifth Circuit to reverse the judgment of said District Court in the above entitled cause:

Now, therefore, the condition of this obligation is such that if the above named Woolford Realty Company, Inc., shall prosecute its said appeal to effect and answer all costs if it fails to make good its plea, then this obligation shall be void; otherwise to remain in full force and effect.

WOOLFORD REALTY COMPANY, INC.,
By JAS. E. DICKEY,
Vice-President.
(Corporate Seal.)
WALTER C. HILL. (L. S.)

Sealed and delivered in the presence of:
ELLINE MARKS,
J. R. ANDREWS.

Approved by:
SAM'L. H. SIBLEY,
United States Judge.

Filed Nov. 22nd, 1930.

17 State of Georgia,
County of Fulton.

Walter C. Hill, security on the within bond, being duly sworn, deposes and says that he is worth the sum of $250.00 over and above his just debts and liabilities and exemptions under the homestead and exemption laws of the State of Georgia.

WALTER C. HILL.

Sworn to and subscribed before me this 22nd day of November, 1930.

J. R. ANDREWS,
(Notarial Seal) Notary Public.

Filed Nov. 22nd, 1930.

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18 PRAECIPE.

(Title Omitted.)

To the Clerk of the above Court:

You are hereby requested to make a transcript of the record to be filed in the United States Circuit Court of Appeals for the Fifth Circuit, pursuant to an appeal allowed in the above entitled cause, and to include in such transcript of record the following and no other papers and exhibits, to-wit:

1. The original petition filed in Office of the Clerk of the District Court on the 18th day of February, 1930, with all entries thereon and exhibits thereto.

2. Defendant's demurrer filed on the 29th day of May, 1930.

3. Opinion of the Court on demurrer, filed 14th day of November, 1930.

4. Order and judgment of the Court made and entered on the .. day of November, 1930.

5. Petition for appeal, with date of filing.

6. Order allowing appeal, with date of filing.

7. Assignment of errors, with date of filing.

19 8. Citation of said petition for appeal and acknowledgment of service thereon, with date of filing.

9. This praecipe with acknowledgment of service thereon, with date of filing.

10. Certificate of the Clerk to the correctness of the record as to praecipe.

W. A. SUTHERLAND,
JOSEPH B. BRENNAN,
Attorneys for Plaintiff.

Filed.

Due and legal service of the within and foregoing praecipe is hereby acknowledged and all other and further service is hereby waived.

This 22 day of November, 1930.

C. P. GOREE,
Asst. United States Attorney.

Filed Nov: 22, 1930.

20 CLERK'S CERTIFICATE.

United States of America,
Northern District of Georgia, ss:

I, O. C. FULLER, Clerk of the District Court of the United States in and for the Northern District of Georgia, do hereby certify that the foregoing and attached 20 pages contains a true, full, complete and correct copy of the original record, assignments of error, and all proceedings had in the matter of Woolford Realty Company, Inc., Appellant, versus J. T. Rose, United States Collector of Internal Revenue for the District of Georgia, Appellee, as specified in the praecipe of counsel herein and as the same remains of record and on file in the Clerk's office of the said District Court, at Atlanta, Georgia, except that the original citation with acknowledgment of service thereon is included herein in the stead of a copy thereof.

In testimony whereof I hereunto set my hand and the seal of the said District Court, at Atlanta, Georgia, this the 4th day of December, A. D. 1930.

O. C. FULLER,
Clerk, United States District Court, Northern District of Georgia.

(Seal)

Original Citation omitted from the printed record, the original thereof being on file in the office of the Clerk of the U. S. Circuit Court of Appeals.

* * * * * * * *

Minute entry of argument and submission, October 6, 1931, omitted in printing.

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 6101

WOOLFORD REALTY COMPANY, INC., Appellant,
versus
J. T. ROSE, Collector of Internal Revenue for the District of Georgia, Appellee

Appeal from the District Court of the United States for the Northern District of Georgia

(November 13, 1931)

Before Bryan, Hutcheson, and Walker, Circuit Judges

OPINION—Filed November 13, 1931

HUTCHESON, Circuit Judge:

In 1925 the Piedmont Savings Company sustained a statutory net loss of $43,478.25; in 1926 it sustained a further statutory net loss of $410.82; it was in those years unaffiliated. In 1927 appellant and the Piedmont Savings Company having become affiliated, a consolidated return for that year was filed. This return disclosed a combined net income for that year of $37,128.83 made up of appellant's net taxable income of $37,582.63 and a loss of Piedmont, $453.80. The Commissioner because Piedmont had no net income in 1927, refused to allow appellant to deduct from the combined net income the statutory net losses of Piedmont incurred in 1925 and 1926, and carried over because of having had no net income in 1926, into the third and second year respectively. The District Judge, taking the same view, denied the claim that because of this disallowance there was an overpayment.

This appeal presents the single question whether statutory net losses, accruing to a corporation when unaffiliated,

may be used by it in a subsequent year when affiliated with another, in computing not simply its own net income, but the net income of the other member of the affiliated group. Or, putting it another way, whether the words "net income" used in Sec. 206b may mean "minus net income" or loss, so as to permit a statutory net loss to be availed of by the affiliated group not merely to the extent of reducing the amount of the net income of the corporation entitled to it on which the affiliated group must pay taxes, but of producing a loss or minus quantity which the affiliated group may use as a deduction from the net income of the other member.

Respondent insists that the whole structure of the taxing system with its emphasis upon gains and losses incurred in the taxable year by the taxpayer, "a person subject to a tax imposed by the Act," makes it plain that both losses and gains must, in order to be taken account of in a return, be the losses and gain of the persons subject to the tax, and except in the single case of Sec. 206 the amortization in prosperous years by the taxpayer incurring it of his statutory net loss, they must be the losses and gains of the taxable year. He declares that the purpose of the taxing statutes as to each person subject to the tax is as to each taxable year, to ascertain, set down and fix what taxable income has accrued to him in that year. That nowhere in the statutes is there any warrant for the view that losses incurred in one year and carried over by statute as net losses by one taxpayer, may be purchased and dealt in, or in any manner acquired by another taxpayer, and used by him as deductions against his own net income. He contends that the taxing statutes use the term "net income" in its real, its natural sense, of a plus, not a minus quantity, meaning "that portion of the receipts of a business which remains after making the deductions allowable by law from its gross income." That it is just as unthinkable to say that net income means either net loss or minus net income as to say that plus and minus are the same.

Appellant on its part insists that to permit respondent's contention to prevail would be to permit a literal construction of the words "net income" in 206b to defeat the clear purpose and intent of that section; that the deduction may be used as one of the factors in ascertaining whether the

taxpayer made a loss or gain for the year, and how much; that the result of this literal construction would be, as to this particular deduction, to deprive an affiliated corporation entitled under Sec. 240 to make a consolidated return, of the full benefit of the deductions to which each member of the group is entitled, contrary to the clear intent of Sec. 240 and the regulations and practices under it. Appellant cites generally in support of its position, the proposition first advanced by the Board of Tax Appeals in Alabama By-Products Corporation, 18 B. T. A. 919, and repeated in later decisions of the Board, that "the statutory net loss is by the plain language of the statute put in the same category as any other deduction allowed by statute in determining an operating gain or loss of one corporation in an affiliated group for the taxable year." It declares, as the Board did in Pittsburgh Gasoline Co., 21 B. T. A. 302, that in determining the net income of a corporate taxpayer the deduction of the net loss of a prior year allowed by Sec. 206 is to be treated the same as the deduction allowed by Sec. 234 whether this deduction produces a net loss, or as the Board calls it, a minus net income. Appellant cites in support of its position the opinions of the Board of Tax Appeals in Alabama By-Products Corporation, 18 B. T. A. 919; Ginsburg Co., 19 B. T. A. 81; Buckie Printers Ink Co., 19 B. T. A. 943; Pittsburgh Gasoline Co., 21 B. T. A. 297; General Box Corporation, 22 B. T. A. 725; Arrow Coal & Ice Co., 22 B. T. A. 1341; Tolerton & Warfield Co., 23 B. T. A. 892; Hawley Investment Co., 23 B. T. A. 953, and National Slag Co. vs. Comr., 47 Fed. (2d) 846.

On the face of it, a ruling which permits a corporation with a consistent record of gains, to affiliate with one having a large accumulation of statutory net losses for the purpose and with the result of using these losses in the year of affiliation as deductions from its income in that year, appears generally inappropriate to the federal scheme of income taxation, designed as it is with the sole exception of the statutory net loss provision, to make each person subject to the tax, pay taxes on his income for the year in which it accrues. The District Judge was impressed with this general inappropriateness; it impresses us. The particular inappropriateness of the contention that in using the words in Sec. 206b "shall be used as a

deduction in computing net income" Congress intended to emphasize not as the object of computation the ascertainment of the net income of the taxpayer for the purpose of determining the tax he should pay, but merely the fact that a computation was to be had for the purpose of finding out whether the taxpayer made a loss or a gain, and the setting down of this figure whether a plus or a minus one, also impresses us.

It seems to us that to give this effect to the words would be to do violence not only to the words themselves, but to the general purpose of the section, which was to give to a taxpayer which had sustained it, the purely personal right (Bush vs. Comr., 50 Fed. (2d) 800) to amortize out of earnings in the second and third years following, losses of the first year, not to give to this statutory net loss a substantive character as an asset which could be traded in through the device of affiliation, and thus, acquired by another taxpayer, used by him as a deduction against his own income.

Were it not for the fact urged upon us by appellant with such earnestness that the Board of Tax Appeals and the Circuit Court of Appeals for the Third Circuit have by construction found that the words in question do have the meaning which appellant contends for, we should take the simple view which Alice took before her encounter with the master logomachist, that words mean what they say, and not the opposite, and simply say, without more ado, that the words "net income" mean net income; they do not, they cannot mean minus net income or loss. That when Congress in Sec. 206b declared that the statutory net loss "shall be allowed as a deduction in computing the net income for the succeeding taxable year" it used these words in their natural, their ordinary sense, to mean "that portion of the receipts of a business which remains after making the deductions allowable by law from the gross income." That they were used with the practical end of taxation in view, determining the amount which the taxpayer will contribute to the support of the Government in the taxable year.

In the light, however, of the contrary view so strongly presented, it is desirable, we think, to examine the words used in the statutes relied on, both in themselves and in their context, to determine whether it is we, or the appellant, who see them through the looking-glass.

The applicable statutes and regulations on which the structure of appellant's argument rests are Rev. Act 1926,

Determination of Net Income.—"In the case of a corporation subject to the tax imposed by Sec. 230, the term 'net income' means the gross income as defined in Sec. 233 less the deductions allowed by Secs. 234 and 206."

Sec. 206 (a) and (b) provides: "(a) As used in this section the term 'net loss' means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations * * * (b) If for any taxable year it appears upon the production of evidence satisfactory to the Commissioner, that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable years (hereinafter in this section called 'second year') and if such net loss is in excess of such net income (computed without such deduction) the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called 'third year')."

Sec. 240 (a). "Corporations which are affiliated * * * may for any taxable year make separate returns, or under regulations * * * make a consolidated return of net income for the purpose of this title, in which case the tax thereunder shall be computed and determined upon the basis of such return." (b) Provides that the total tax shall be computed in the first instance as a unit, and shall then be assessed upon the respective corporations as they shall agree, or on the excess of the net income properly assessable to each."

In Regulation 69 Art. 635 Consolidated Net Incomes of Affiliated Corporations, it is provided:

"Subject to the provisions covering the determination of taxable net income of separate corporations * * * the consolidated taxable net income shall be the combined net income of the several corporations consolidated. In respect of the statement of gross income and deductions a corporation filing a consolidated return must show * * * the details of the items of gross income and deductions for each corporation included in the consolidation."

Appellant supplements its contention that the words themselves simply and plainly mean that the statutory net loss shall be allowed as any other deduction is, in arriving at the result of the taxpayer's business for that year whether it is a plus or a minus quantity, by arguing that there is in neither 206b, the net loss section, nor in Sec. 240, or any regulation under either, any provision directing that this deduction be differently treated in making up consolidated returns. He declares that though no new taxpayer has resulted from the affiliation, and the individuals who compose the group are still the statutory taxpayers, the affiliated group in reality constitutes a tax unit, a quasi taxpayer, "a person subject to the tax," "whose income and capital stock are really the income and capital stock of a single enterprise." Ice Service Co. vs. Comr., 30 Fed. (2d) 230; National Slag Co. vs. Comr., 47 Fed. (2d) 846; Flanary vs. Comr., 42 Fed. (2d) 11, and that since it is the combined net income which is being sought in the case of a consolidated return, and that income is the result of the deduction from the aggregate of the gross income of all of the affiliates of their gross allowable deductions, it is to impress a too literal and arbitrary meaning upon the words "net income" as used in the net loss statute, to limit it to a plus quantity, when the same term as to all other deductions is used both in a plus and minus sense, to mean a profit or a loss.

Of course if appellant is right in its assumption that the statutory net loss deduction must be treated like any other deduction in making up a consolidated return, it is right in its conclusion that it should have had the benefit of it here. If, on the other hand as we think, this is a special deduction available only in strict accordance with the terms of the statutes which give it, appellant is wrong and it should have been disallowed.

We think the assumption of appellant and its argument in support of it overlooks the point that taxes go by years, and that though in the taxable year in question the individual corporations are still taxpayers, the business is really regarded for the purpose of taxation, as a unit, and as such subject to tax on the business of that year. Because the income on which the tax shall be paid in the taxable year, though made up of the results of the busi-

ness of each affiliate, is not the income of each individual taxpayer, but the income of the unit for that year, the Commissioner was right in allowing against the aggregate gross income of the business for that year the aggregate deductions applicable to that year. This treatment gives full effect to the purpose of the statute to allow affiliates to transact their business as freely as though they were one corporation acting through departments, with the assurance to the Government and the taxpayer alike that the taxes payable as the result of the business done by the taxable unit in that year will, without reference to the bookkeeping of the individual corporations, be paid upon the whole business done by the unit, taking into consideration all of the earnings and all of the deductions of the branches of the business, not separately but in the aggregate, just as though in that year there was no separate corporate structure, but one corporation maintaining many departments.

When, however, it is sought to extend the grant of the statute authorizing a taxpayer to offset the earnings of subsequent years against the loss of a prior year so as to confer upon an affiliated group the extraordinary privilege of deducting from its earnings actual losses, which neither it nor its affiliates incurred in the taxable year of the affiliated group, the one making this claim must be able to point to clear and unmistakable language authorizing that extension.

Apart from the nice verbal construction of Secs. 206 and 240 which supports the view that Sec. 206 may not be so extended, we think no other view consonant with the general intent and purpose of the two statutes. The view we take gives full effect to them both. It does not permit affiliation to deprive the taxpayer of his net loss privilege or in any manner diminish it. It does not permit affiliation to enlarge or in any manner change it. This personal privilege, extended to the individual taxpayer to palliate the rigidity of the annual system of taxation, and to spread over the two succeeding years for the purpose of deduction in them from the net income which the taxpayer might make in those years, losses which though not all actually accruing in the one year, were perhaps the foundation of the income of the following years, we think should be given the full effect intended. It should not be by construction

extended to the unreasonable result of permitting a corporation having no connection whatever with the losses, to avail itself of them as a positive deduction through the device of affiliation.

While appellant does find support for the position which it takes, in the opinions of the Board of Tax Appeals, we cannot agree with the view which the Board takes. Whether the decision in the National Slag Co. case supra was or not correct, it did not decide the point before us. That case merely decided that since one Buckland had during the years in which the statutory net losses were sustained, as well as during the year of affiliation, owned both of the enterprises, the loss was really his loss, and the statute should be construed so as to give him the benefit of it.

Decisions which though not directly in point, in principle support the position we take, that statutory net loss is individual to the taxpayer incurring it and may be availed of by him to the extent of his net income, are Swift vs. United States, 38 Fed. (2d) 365; The Sweets Co. of America vs. Comr., 40 Fed. (2d) 346; Burnett vs. Moore Cotton Mills, 49 Fed. (2d) 239; cf. Planters Oil Co. vs. Hopkins, 47 Fed. (2d) 659; Bush vs. Comr., 50 Fed. (2d) 800; First National Bank of Chicago vs. U. S., 283 U. S. 142.

The judgment of the Court below is affirmed.

IN UNITED STATES CIRCUIT COURT OF APPEALS

No. 6101

WOOLFORD REALTY COMPANY, INC.,

versus

J. T. ROSE, Collector of Internal Revenue for the District of Georgia

JUDGMENT—November 13, 1931

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Georgia, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

MOTION TO STAY ISSUANCE OF MANDATE—Filed Nov. 24, 1931

Now comes Woolford Realty Company, Inc., the appellant in the above entitled cause, and shows to this Court that it intends to apply to the Supreme Court of the United States for a writ of certiorari to review the judgment rendered by this Court, and that it intends to make said application within thirty days after the time when the mandate of this Court would normally issue under Rule XXXII.

Wherefore Appellant prays that the mandate of this Court be stayed and withheld until January 3, 1932, or in the event that a petition for certiorari is filed and docketed in the Supreme Court prior to the expiration of said time, then until final disposition of the cause in the Supreme Court.

This 19 day of November, 1931.

(Signed) W. A. Sutherland, Joseph B. Brennan, Attorneys for Appellant.

IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

ORDER STAYING MANDATE—Filed Nov. 24, 1931

On consideration of the application of the appellant in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable appellant to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, it is ordered that the issue of the mandate of this court in said cause be and the same is stayed

for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate of the clerk of the Supreme Court that the certiorari petition and record have been filed, and that due proof of service of notice thereof under Paragraph 3 of Rule 38 of the Supreme Court has been given. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

Done at New Orleans, La., this 24th day of November, 1931.

(Signed) N. P. Bryan, United States Circuit Judge.

Clerk's certificate to foregoing transcript omitted in printing.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed January 25, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 36,396. U. S. Circuit Court of Appeals, Fifth Circuit. Term No. 582. Woolford Realty Company, Inc., petitioner, vs. J. T. Rose, Collector of Internal Revenue for the District of Georgia. Petition for a writ of certiorari and exhibit thereto. Filed December 21, 1931. File No. 36,396.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 582

WOOLFORD REALTY COMPANY, INC., PETITIONER,

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

W. A. SUTHERLAND,
Counsel for Petitioner

Of Counsel:
ELBERT P. TUTTLE,
JOSEPH B. BRENNAN

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. ——

WOOLFORD REALTY COMPANY, INC., PETITIONER,

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA

PETITION FOR WRIT OF CERTIORARI

May it Please the Court:

The petition of Woolford Realty Company, Inc. respectfully shows to this Honorable Court:

A

SUMMARY STATEMENT OF THE MATTER INVOLVED

Petitioner sued the Respondent to recover certain Federal income taxes alleged to have been erroneously and illegally collected. Petitioner's declaration showed the following facts (R. 2-6):

Petitoner and Piedmont Savings Company are separate corporations. They were not affiliated in 1925 and 1926, but were affiliated throughout 1927 through the ownership by Petitioner of 96% of the stock of Piedmont Savings Company. The corporations filed separate returns for 1925 and 1926, but filed a consolidated return for 1927 under Section 240 of the Rev-

enue Act of 1926,[1] which return was accepted by the Commissioner. In computing the consolidated net income of the group for 1927 for income tax purposes, the Commissioner of Internal Revenue has taken into consideration the deductions allowable to each of the members of the group under Section 234 of the Revenue Act of 1926, but the Commissioner has refused to allow as deductions claimed under Section 206 of that Act, the amounts of certain statutory "net losses" (as defined in Section 206) sustained by Piedmont Savings Company in the years 1925 and 1926. Upon this basis the Commissioner has determined a consolidated net income of $36,133.82, and income taxes have been assessed and paid on this amount.

It is not disputed that the statutory "net losses," referred to above, were sustained by Piedmont Savings Company in the amount of $43,478.25 in 1925 and in the amount of $410.82 in 1926, or in a total amount for the two years of $43,889.07. Petitioner claims that the amount of these statutory "net losses" should be allowed as deductions in the computation of consolidated net income for 1927. If such deductions are allowed, the aggregate of allowable deductions would have exceeded the aggregate gross income, and no income tax would be payable under the consolidated return. A claim for refund was filed and suit was brought for the recovery of the income taxes thus paid for 1927.

The District Court sustained Defendant's general demurrer to the declaration, and on appeal the Circuit Court of Appeals for the Fifth Circuit affirmed the judgment of the District Court.

The Circuit Court of Appeals took the position "that the statutory net loss deduction was personal to the taxpayer sustaining it and could be availed of in the following year by that taxpayer alone, and by him only to the extent that he had net

[1]Pertinent statutory provisions and Treasury Regulations are quoted in full in an appendix to the brief in support of this petition.

income in that year."[2] The learned Judge apparently means by "net income" the amount by which gross income exceeds the deductions allowable under Section 234(a) and is of the opinion that where these deductions exceed gross income there is no net income. Since in 1927 the gross income of Piedmont Savings Company was exceeded by the deductions allowable to Piedmont Savings Company under Section 234 of the Revenue Act of 1926, the Court held that Piedmont Savings Company had no "net income" and that therefore its "net losses" for the two preceding years were not deductible and should be disregarded in the computation of consolidated net income.

B

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

1. The Circuit Court of Appeals has herein decided an important question of Federal Law which has not been, but should be, settled by this Court. The question is whether a statutory "net loss" incurred by a corporation in one year may be used to reduce the consolidated net income of an affiliated group, of which such corporation is a member, in another year in which the corporation which has sustained the "net loss" has, without consideration of the "net loss," no separate "net income" of a plus quantity. The Board of Tax Appeals and the lower Federal Courts have already decided numerous cases[3] involving this

[2]The quotation is from the opinion of the Circuit Court of Appeals for the Fifth Circuit in the case of *Planters' Cotton Oil Co., Inc. v. Hopkins*, decided November 20, 1931, where the Court describes its holding in the case at bar.

[3]*National Slag Co. v. Commissioner*, 47 F. (2d) 846 (C. C. A. 3rd, 1931); *Commissioner v. Ben Ginsburg Co.*, Unreported (C. C. A. 2nd, November 2, 1931); *Planters' Cotton Oil Co., Inc. v. Hopkins*, Unreported (C. C. A. 5th, November 20, 1931); *s. c.* 47 F. (2d) 659 (N. D. Tex. 1931); *Alabama By-Products Corporation*, 18 B. T. A. 919; *Ginsburg Co.*, 19 B. T. A. 81; *Buckie Printers' Ink Co.*, 19 B. T. A. 943; *Pittsburgh Gasoline Co.*, 21 B. T. A. 297; *General Box Corporation*, 22 B. T. A. 725; *Arrow Coal & Ice Company*, 22 B. T. A. 1341; *Tolerton & Warfield Company*, 23 B. T. A. 892; *Hawley Investment Company*, 23 B. T. A. 953; *Small's, Inc.*, 24 B. T. A. __; *Abelson Realty Company, Inc.*, 24 B. T. A. __; *Summerfield Co.*, 24 B. T. A. __.

question, and undoubtedly hundreds of other cases are still pending before the Bureau of Internal Revenue, the Board of Tax Appeals and the Courts. It is most important, therefore, that this Court settle the question and put an end to the uncertainty and confusion which is causing such widespread dispute before the Courts, the Board of Tax Appeals and the Bureau of Internal Revenue.

2. The decision rendered by the Circuit Court of Appeals in this case is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the case of *National Slag Co. v. Commissioner of Internal Revenue*, 47 F. (2d) 846 (1931)[4].

3. The Circuit Court of Appeals has disregarded the clear and repeated holdings of this Court to the effect that the rule requiring adherence to the letter of a statute applies with peculiar strictness to taxing acts and to the effect that such statutes are not to be extended by implication beyond the clear import of the language used and must in all cases of ambiguity be construed most liberally in favor of the taxpayer[5].

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[4]The decision in the case at bar is also in conflict with all of the decisions of the Board of Tax Appeals cited in the preceding footnote. The case of *Summerfield Co.*, there cited, was decided by the Board after its attention had been called to the conflicting decision of the Circuit Court of Appeals for the Second Circuit in the case of *Ben Ginsburg Co.*, supra. In the *Summerfield* case the Board adhered to its own line of decisions, calling attention to the split among the Circuit Courts of Appeals.

[5]*Crooks v. Harrelson*, 282 U. S. 55, 61 (1930); *United States v. Merriam*, 263 U. S. 179, 187-188 (1923); *United States v. Updike*, 281 U. S. 489, 496 (1930); *Reinecke v. Trust Company*, 278 U. S. 339, 348 (1929); *Bowers v. New York & Albany Lighterage Company*, 273 U. S. 346, 350 (1927); *Shwab v. Doyle*, 258 U. S. 529, 536 (1922); *Gould v. Gould*, 245 U. S. 151, 153 (1917); *Benziger v. United States*, 192 U. S. 38, 55 (1904).

WHEREFORE, your Petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Fifth Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 6101, Woolford Realty Company, Inc., Appellant, v. J. T. Rose, Collector of Internal Revenue for the District of Georgia, Appellee, and that the said judgment of the Circuit Court of Appeals for the Fifth Circuit may be reversed by this Honorable Court, and that your Petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your Petitioner will ever pray.

WOOLFORD REALTY COMPANY, INC.

By W. A. SUTHERLAND,

Counsel for Petitioner

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

WOOLFORD REALTY COMPANY, INC., PETITIONER,

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

The Opinions of the Courts Below

The opinion in the Circuit Court of Appeals for the Fifth Circuit, which was rendered on November 13, 1931, has not yet been printed in the Federal Reporter. The opinion is printed at pages 17 to 24, inclusive, in the record. The opinion of the District Court for the Northern District of Georgia is reported at 44 F. (2d) 856.

II

Jurisdiction

1. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended, United States Code, Title 28, Section 347.

2. The date of the judgment to be reviewed is November 13, 1931 (R. 25).

III

Statement of the Case

A full statement of the case is given under heading "A" in the foregoing petition and, in the interest of brevity, the statement is not repeated here.

IV

Specification of Errors

1. The Circuit Court of Appeals erred in finding and holding that a statutory "net loss" (within the meaning of Section 206 of the Revenue Act of 1926) incurred by a corporation in one year (1925 and 1926), when not affiliated, may not be used to reduce consolidated net income (within the meaning of Section 240 of the Revenue Act of 1926) of an affiliated group, of which such corporation is a member, in a subsequent year (1927) in which the corporation which has sustained the "net loss" does not have gross income in excess of the deductions allowed by Section 234(a) of the Revenue Act of 1926.

2. The Circuit Court of Appeals erred in affirming the judgment of the District Court sustaining the general demurrer to the petition.

V

Argument

The argument herein will follow the order of the reasons for the allowance of the writ set forth in the petition.

1. THE CIRCUIT COURT OF APPEALS IN THIS CASE HAS ERRONEOUSLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

The first reason for the allowance of the writ stated in the petition shows the question involved and the importance of a decision by this Court thereon. The statement of that reason is

not repeated here. While no attempt is made in this brief to present a thorough argument on the merits of Petitioner's contentions, a brief analysis of the pertinent statutory provisions is made for the purpose of presenting clearly the question involved and the importance of a decision thereon by this Court.

The question in this case involves the determination of consolidated net income. We discuss first the provisions for the determination of the net income of a single taxpayer.[6] The determination of consolidated net income is absolutely dependent upon these provisions.

Section 232 provides:

> "Sec. 232. In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233, less the deductions allowed by sections 234 and 206, . . ."

Section 234(a) provides:

> "Sec. 234(a). In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:"
>
> [There are then listed, under sub-paragraphs (1) to (11), all deductions permitted in determining net income, except "*net losses*" brought forward from preceding years, which is covered by Section 206].

Section 206(a) provides for the determination according to peculiar statutory provisions of what that Section designates as a "net loss." That the "*net loss*" defined in Section 206(a) is a statutory concept and not to be confused with *loss* in general, is made clear by Article 1621 of the Regulations, which provides:

---

[6]All pertinent provisions of the Statutes and Regulations are quoted at length in an appendix to this brief. Throughout this brief references to Section and Article numbers relate to Sections of the Revenue Act of 1926 and Articles of Regulations 69, unless otherwise indicated.

"Art. 1621. . . . The amount properly allowed (as a 'net loss') may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute. . . ."

Section 206(b) with reference to the deduction of these statutory "net losses" from gross income in succeeding years provides:

"Sec. 206(b). If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Section 240(b), covering cases where corporations are affiliated and a consolidated return is filed, provides:

"Sec. 240(b). . . . the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations (in the proportions provided). . . ."

Article 635 of Regulations 69, promulgated under Section 240, eliminates intercompany transactions and provides:

"Art. 635. Subject to the provisions covering the determination of taxable net income of separate corporations, . . . the consolidated taxable net income shall be the combined net income of the several corporations consolidated. . . ."

A mere reading of the provisions of the statute and regulations with reference to the determination of consolidated net income would seem to make it too clear for argument that the net income of a consolidated group is to be computed by taking the aggregate of the gross income of each member of the group and subtracting from this aggregate gross income the aggregate of all the deductions provided for each member of the group. Article 31(a) of Regulations 75, promulgated under substantially similar provisions of the Revenue Act of 1928, expressly provides that consolidated net income is to be determined in this manner.[7]

It is not disputed in this case that Petitioner and Piedmont Savings Company were not affiliated during the years 1925 and 1926, when "net losses" were incurred by Piedmont Savings Company, and for the year 1927 were affiliated and were authorized to and did make a consolidated return of net income for the purpose of taxation under the Act. And it is not disputed that the gross income of Piedmont Savings Company for the year 1927 was $453.80 less than the deductions allowable to it by Section 234(a).

The Circuit Court of Appeals has recognized the propriety of subtracting from the aggregate gross income of the two corporations all of the deductions allowable to each of the members of the group by Section 234(a), notwithstanding the fact that the aggregate of the deductions allowed on account of the Piedmont Savings Company by Section 234(a) was in excess of its gross income. But the Court has denied the propriety under such circumstances of deducting from gross income the "net loss" deductions of Piedmont Savings Company allowed

[7] "Reg. 75, Art. 31(a). *Definition.* Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as 'intercompany transactions')." (Cf. Rev. Act. 1928, Sec. 141.)

by Section 206(b). There is no basis whatever for making any distinction in a consolidated return between the deductions allowed by Section 234(a) and those allowed by Section 206(b). If the former deductions are permitted when in excess of the gross income of the separate corporation sustaining same, the latter must likewise be allowed.

From the opinion as a whole it seems that the Court reaches its decision adverse to Petitioner's contention upon the theory that the construction for which Petitioner contends would accomplish an inequitable result and a result "generally inappropriate to the Federal scheme of income taxation designed as it is *with the sole exception of the statutory net loss provision* to make each person subject to tax pay taxes on his income for the year in which it accrues." (R. 20.) (Italics ours.) This brief does not permit a full analysis of the error of this view. The fallacy of the assumption upon which this holding is based is clearly established by the fact that in Article 41(c) of Regulations 75, promulgated under substantially similar provisions of the Revenue Act of 1928, the Commissioner and Secretary of the Treasury expressly permit the deduction which Petitioner here contends is allowable.[8] The error of the Court's approach to the question is more fundamental. This is discussed under heading 3, page 20, infra.

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[8]"Art. 41(c). *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.* A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

It should be noted that the limitation of the net loss deduction to the cost to the affiliated group of the stock in the corporation which sustained the net loss prior to affiliation has no application whatever to any case where the affiliation occurred prior to January 1, 1929, the regulations being promulgated on January 3, 1929.

The language in some portions of the opinion of the Circuit Court of Appeals seems to indicate that the Court assumes that the literal language of Section 206(b), to the effect that the net loss deduction is to be allowed in the succeeding year in computing "the net income of the *taxpayer*" (Italics ours), requires that this deduction be limited to the individual taxpayer which sustained the loss. It could be argued with as much reason that the ordinary deductions allowable under Section 234(a) cannot be used in the computation of consolidated net income because Section 234(a) provides that "in computing the net income of *a corporation* subject to the tax imposed by Section 230 there shall be allowed as deductions" (Italics ours) the items there listed. An argument that the literal words of either section do not provide for the allowance of these deductions in the computation of consolidated net income would be clearly erroneous. Of course Sections 234(a) and 206(b) refer to single taxpayers. But Article 635, promulgated under Section 240, which provides that the income of the consolidated group shall be "the combined net income of the several corporations consolidated," necessarily means that all the items of gross income and all the deductions of the individual taxpayer must be taken into account. Otherwise it means nothing, and leaves to the Commissioner's caprice in each individual case, or to the individual opinion of whatever Court happens to be considering the matter, the determination of what, and under what circumstances, deductions are or are not allowable in a consolidated return. Section 240 and Article 635 expressly provide for the extension and enlargement of the provisions of the Act relating to the gross income and deductions of single taxpayers to make them applicable to an affiliated group. They do not leave the Commissioner or the Courts any more latitude in saying which of the particular deductions granted by statute shall be allowed to the consolidated group than they leave the Commissioner or a Court to say what deductions shall be permitted to a single taxpayer.

In other portions of the opinion it is intimated that Petitioner's contention requires the concept of "net income" as a minus quantity. Such is not the case if the provisions of Article 635 are interpreted, as we interpret them, as providing for the computation of consolidated net income by deducting from the aggregate of the gross income of the several corporations the aggregate of the deductions allowable under Sections 234(a) and 206(b). If, however, Article 635 is taken to require the computation of net income for each separate corporation, and then the combination of these separate net incomes, the concept of net income as a minus quantity is necessary. "Net income" as used in the Act *is a creature of statute* and is fully defined in Section 232. We find no difficulty in admitting the concept of net income as a minus quantity. It will always be a minus quantity when the deductions allowable by Section 234(a) or Section 206(b), or both combined, exceed gross income as defined in Section 233. In this case the Commissioner himself has allowed a minus figure, (which, upon this theory, must be *minus net income*) for the Piedmont Savings Company, to be combined with the plus net income of Petitioner in arriving at consolidated net income. The Court and Commissioner have refused to permit this minus figure to be increased by the deduction allowable under Section 206(b). (See page 13, supra.)

2. THE DECISION OF THE CIRCUIT COURT OF APPEALS IN THIS CASE IS IN CONFLICT WITH THE DECISION OF ANOTHER CIRCUIT COURT OF APPEALS ON THE SAME MATTER.

In the case of *National Slag Co. v. Commissioner*, 47 F. (2d) 846 (C. C. A. 3rd, 1931), it appeared that the National Slag Co. was affiliated with the Quakertown & Bethlehem Railroad Company throughout the year 1924. These two corporations were not affiliated in 1922 and 1923, in which years the Railroad Company had sustained "net losses" within the meaning of Section 206(b) of the Revenue Act of 1924, which is identical with Section 206(b) of the Revenue Act of 1926. In

1924 the Railroad Company's gross income was less than the deductions allowed by Section 234(a). The question presented to the Circuit Court of Appeals for the Third Circuit in that case is stated in the opinion of that Court as follows:

> "The single question here is whether the net losses sustained by the railroad company in 1922 and 1923 are allowable as deductions in computing the net income on the affiliated return of the companies for 1924; or to put the concrete question in general terms, it is, whether corporations affiliated for the year 1924, but not affiliated prior thereto, may add the loss of a member of the group, sustained in 1922 and 1923 to the loss of the same member sustained in the year 1924 in determining the loss of such member that may be deducted from the gross income of the group for the taxable year, 1924."

The Commissioner had disallowed the deductions of the net losses of the Railroad Company for 1922 and 1923 on the ground that "such losses may not be used to reduce consolidated net income for the year 1924 since the Quakertown & Bethlehem Company had no net income in 1924 to absorb the losses of 1922 and 1923." The Board of Tax Appeals had sustained this action of the Commissioner and had disallowed these losses.

But the Circuit Court of Appeals pointed out that shortly after the decision of the Board of Tax Appeals in the *National Slag Co.* case, the Board of Tax Appeals decided the case of *Alabama By-Products Corporation*, 18 B. T. A. 919, in which case the Board expressly overruled its decision in the *National Slag Co.* case. After analyzing the applicable statutory provisions, the Circuit Court of Appeals for the Third Circuit came to the conclusion that "the deduction of the losses here in question, sustained in 1922 and 1923, come directly within the provisions of the statute which are plain, certain and unambiguous." That Court held, therefore, that the statutory "net losses" suffered by the Railroad Company in 1922 and 1923

should be used to reduce the consolidated net income in 1924 of the affiliated group, of which the Railroad Company was a member, although the Railroad Company suffered a further loss in 1924.

The decision of the Circuit Court of Appeals for the Third Circuit in the *National Slag Co.* case is directly in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the case at bar.

The Circuit Court of Appeals in this case has pointed out a difference between the facts of this case and the facts of the *National Slag Co.* case. But even the slightest examination of this factual difference will show clearly that it cannot be the basis of a legal distinction. The Court refers to the *National Slag Co.* case near the end of its opinion (R. 24), where the following remarks are made:

> "Whether the decision in the National Slag Co. case was or not correct, it did not decide the point before us. That case merely decided that since one Buckland had during the years in which the statutory net losses were sustained, as well as during the year of affiliation, owned both of the enterprises, the loss was really his loss, and the statute should be construed so as to give him the benefit of it."

In the first place, it cannot be supposed that the Circuit Court of Appeals for the Third Circuit intended to limit its decision to any question narrower than the question quoted above from its opinion. It is true that in the *National Slag Co.* case it appeared that during 1922 and 1923, when the Railroad Company sustained net losses, the same individual who owned the Railroad Company also owned the business which was later turned over to the Slag Co. when that Company was incorporated on January 1, 1924. But there is nothing in the statutes that would give any legal significance to this fact. Indeed the Circuit Court of Appeals for the Fifth Circuit has itself recognized, in a case decided after the case at bar, that this factual

element in the *National Slag Co.* case does not explain the conflict between the decisions of the two Courts. In the case of *Planters' Cotton Oil Co., Inc. v. Hopkins*, decided by the Circuit Court of Appeals for the Fifth Circuit on November 20, 1931, the Court expressly stated that the factual difference between the *National Slag Co.* case and the *Woolford Realty Co.* case could not be made the basis of a legal distinction. Judge Hutcheson, again speaking for the Court, in the *Planters' Cotton Oil Co.* case, says:

> "Were this a case as that one was (referring to the Woolford Realty Co. case), of corporate affiliation of interests theretofore distinct, brought about after the net losses had been sustained, we should dispose of this case by a mere reference to that opinion. Since, however, the differentiating facts appear here as they did in the case of National Slag Co. v. Com'r., 47 F. (2d) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies, in the Slag case two companies so owned having been consolidated, in this case five companies so owned having been created by carving three out of the two which had sustained the net loss, *it becomes necessary for us now to determine whether these differences of fact require a different legal conclusion. We do not think they do.*" (Italics ours.)

The Court, therefore, reached the same decision that was reached in the case at bar.

It is respectfully submitted that there can be no doubt that the decision of the Circuit Court of Appeals in the case at bar is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the *National Slag Co.* case.

The case of *Commissioner v. Ben Ginsburg Co.*, decided by the Circuit Court of Appeals for the Second Circuit on Novem-

ber 2, 1931, is clearly recognized by that Court as being in direct conflict with the decision of the Third Circuit in the *National Slag Co.* case.

3. THE CIRCUIT COURT OF APPEALS HAS DISREGARDED THE CLEAR AND REPEATED HOLDINGS OF THIS COURT TO THE EFFECT THAT THE RULE REQUIRING ADHERENCE TO THE LETTER OF A STATUTE APPLIES WITH PECULIAR STRICTNESS TO TAXING ACTS AND TO THE EFFECT THAT SUCH STATUTES ARE NOT TO BE EXTENDED BY IMPLICATIONS BEYOND THE CLEAR IMPORT OF THE LANGUAGE USED AND MUST IN ALL CASES OF AMBIGUITY BE CONSTRUED MOST LIBERALLY IN FAVOR OF THE TAXPAYER.

The analysis of the question involved in this case, made under heading 1, supra, shows that the Court below construes the statute and regulations against the interests of Petitioner in order to reach what the Court considers to be a result in keeping with the general purposes and intent of the statute. (Page 14, supra.) This is in utter disregard of the uniform holdings of this Court to the effect that the rule, which requires that a statute shall be interpreted according to its language and not in accordance with what the Court conceives to be its general purpose and intent, applies with especial strictness to taxing statutes which are in all cases to be limited to the words of the statute and are not to be extended upon equitable considerations. *Crooks v. Harrelson*, 282 U. S. 55, 61 (1930); *United States v. Merriam*, 263 U. S. 179, 187-188 (1923). There is no excuse whatever for a violation of this rule when, as here, a literal construction produces no unreasonable result.[9]

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[9]The decision of the Circuit Court of Appeals for the Fifth Circuit in this case, and especially the approach of the Court to the issue involved, is in striking contrast with the decision of the Circuit Court of Appeals for the Fourth Circuit in the case of *Burnet v. Moore Cotton Mills*, 49 F. (2d) 59, 61 (2) (C. C. A. 4th, 1931), where the reasoning of the Circuit Court of Appeals for the Fourth Circuit on an analogous question is directly in conflict with the reasoning of the Circuit Court of Appeals for the Fifth Circuit in this case.

In the worst view of Petitioner's case the language can only be said to be ambiguous. Certainly the language does not clearly support, and the Circuit Court of Appeals did not hold that it clearly supports, its position. Another rule of construction repeatedly and emphatically laid down by this Court would require that if the language is ambiguous any doubt should be resolved in favor of the taxpayer.[10] The Court has completely disregarded this rule.

The soundness of the principle (applied with particular strictness to taxing statutes) that effect is to be given to the language rather than the supposed purpose of Congress, is illustrated with particular force in the present situation, where the express regulations of the Commissioner, under a statute for present purposes altogether identical with the statute here in question, has expressly permitted in specific terms the identical deduction which the Circuit Court of Appeals for the Fifth Circuit in this case held to be "generally inappropriate to the Federal scheme of income taxation."

The error of the Circuit Court of Appeals in this respect alone would be quite sufficient to warrant this Court in granting certiorari; so that it may lay down again, with an emphasis which cannot be misunderstood, the proposition that Courts are to follow the language of taxing statutes and not their own conceptions as to what in a particular case would be in keeping with the general purposes which Congress had in mind. Had the mind of the Circuit Court of Appeals been disabused of this error, its decision would undoubtedly have been different.

CONCLUSION

It is respectfully submitted that the question of Federal law involved in this case is a most important one and should be settled by this Court. The increasing number of cases in which the lower Federal Courts and the Board of Tax Appeals are deciding this question demonstrate its importance. Conflicting

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[10]See cases cited in footnote 5, supra.

decisions of the Circuit Court of Appeals create an unsatisfactory situation in any case. Such a conflict is most unfortunate in a question of Federal Income Tax Law where uniform administration throughout the country is required. Moreover, in reaching its conclusion the Circuit Court of Appeals has, it is submitted, violated the rules that statutes, and especially provisions of statutes imposing taxes, are not to be extended by implication beyond the clear import of the language used, and that all provisions of Revenue Acts are to be construed most liberally in favor of taxpayers. It is therefore respectfully urged that this Court grant the writ of certiorari.

Respectfully submitted,

W. A. SUTHERLAND,
Atlanta, Georgia

Of Counsel:

ELBERT P. TUTTLE,
JOSEPH B. BRENNAN
Atlanta, Georgia

APPENDIX

Statutes and Regulations Involved

Revenue Act of 1926, Section 232:

In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, . . .

Revenue Act of 1926, Section 234(a):

In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

[There are then listed, under sub-paragraphs (1) to (11), all deductions permitted in determining net income, except "net losses" brought forward from preceding years, which is covered by Section 206. The deductions listed under Section 234(a) include ordinary and necessary expenses, interest and taxes paid, losses sustained, bad debts, dividends from domestic corporations, depreciation, obsolescence and depletion.]

Revenue Act of 1926, Section 206(a) and (b):

(a). As used in this section the term "net loss" means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations:

(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

(2) In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;

(3) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to paragraph (2) of subdivision (c) of section 204;

(4) The deduction provided for in paragraph (6) of subdivision (a) of section 234 of amounts received as dividends shall not be allowed;

(5) There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234.

(b). If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Revenue Act of 1926, Section 240(a) and (b)

(a). Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is

made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b). In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236.

Regulations 69, Article 635:

Consolidated net income of affiliated corporations.— Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. Only one specific credit of $2,000, as provided in section 236(b) and article 591, shall be allowed the consolidated group, and this only in case the net income of the group does not exceed $25,000; but if such net income is more than $25,000, the tax imposed by section 230 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000. In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for

each corporation included in the consolidation may be readily audited.

Revenue Act of 1928, Section 117(a) and (b):

[Section 117(a) of the Revenue Act of 1928 *defines* "net loss" under the 1928 Act and does not differ in any way here material from Section 206(a) of the Revenue Act of 1926, page 23, supra. Section 117(b) with reference to the *deduction* of "net losses" is identical with Section 206(b) of the Revenue Act of 1926, page 24, supra.]

Revenue Act of 1928, Section 141(a), (b) and (c):

(a) *Privilege to file consolidated returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) *Regulations.*—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(c) *Computation and payment of tax.*—In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the date on which such return is made. Only one specific credit computed as provided in section 26(b), shall be allowed in computing the tax.

Regulations 75, Article 31(a):

Definition.—Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as "intercompany transactions").

Regulations 75, Article 41(c):

Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.—A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group.

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Supreme Court of the United States

OCTOBER TERM, 1931

No 582

WOOLFORD REALTY COMPANY, INC.,

PETITIONER,

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA

On Writ of Certiorari to the Circuit Court of Appeals for the Fifth Circuit

---

BRIEF FOR THE PETITIONER

W. A. SUTHERLAND,
Counsel for Petitioner

Of Counsel:
ELBERT P. TUTTLE,
JOSEPH B. BRENNAN

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No. 582

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On Writ of Certiorari to the Circuit Court of Appeals for the Fifth Circuit

BRIEF FOR THE PETITIONER

Opinions Below

The opinion of the Circuit Court of Appeals for the Fifth Circuit is reported at 53 F. (2d) 821. The opinion of the District Court for the Northern District of Georgia is reported at 44 F. (2d) 856.

Jurisdiction

The judgment of the Circuit Court of Appeals for the Fifth Circuit was entered November 13, 1931 (R. 24). Petition for writ of certiorari was filed

December 21, 1931, and the writ was granted January 25, 1932 (R. 26). The jurisdiction of this Court rests on Section 240 of the Judicial Code as amended, 28 U. S. C. Sec. 347.

Question Presented

This case presents the question whether, under the Revenue Act of 1926, "net losses" sustained by a corporation in two years when it was not affiliated with any other corporation may be used as deductions in computing the consolidated net income of that corporation and another corporation in the succeeding year during which the two corporations were affiliated and for which a consolidated return was filed, when the corporation which had sustained the "net losses" has, without consideration of such "net losses," no separate net income of a plus quantity in such succeeding year.

Statutes and Regulations Involved

The statutes and regulations involved are rather lengthy and are all quoted in the Appendix, and extracts from same are quoted in the text where it is thought to be more convenient to give quotations than to refer to the Appendix.

Statement of the Case

Petitioner sued the Respondent to recover certain income taxes alleged to have been erroneously and illegally collected. Petitioner's declaration showed the following facts (R. 2-6):

Petitioner and Piedmont Savings Company are separate corporations. They were not affiliated in 1925 and 1926, but were affiliated throughout 1927

through the ownership by Petitioner of 96% of the stock of Piedmont Savings Company. The corporations filed separate returns for 1925 and 1926, but filed a consolidated return for 1927 under Section 240 of the Revenue Act of 1926.[1]

In computing the consolidated net income of the group for 1927 for income tax purposes, the Commissioner of Internal Revenue has taken into consideration and allowed all the deductions allowable to each of the members of the group under Section 234 of the Revenue Act of 1926, but the Commissioner has refused to allow as deductions claimed under Section 206 of that Act, the amount of certain statutory "net losses" (as defined in Section 206) sustained by Piedmont Savings Company in the years 1925 and 1926, in the respective amounts of $37,582.63 and $453.80. If such deductions were allowed, or if the amount of the "net loss" for 1925 alone were allowed, the allowable deductions would have exceeded the aggregate gross income, and no income tax would be payable under the consolidated return. A claim for refund was filed and this suit was brought upon its rejection. A demurrer to the petition was sustained by the District Court. (R. 8-10.) Judgment was entered dismissing the petition (R. 10), which was affirmed by the Circuit Court of Appeals for the Fifth Circuit (R. 17-25).

Although recognizing the propriety of allowing full use of all deductions available to Piedmont Sav-

[1]Pertinent statutory provisions and Treasury Regulations are quoted in full in an Appendix to this brief. Throughout this brief references to Section and Article numbers relate to Sections of the Revenue Act of 1926 and Articles of Regulations 69, unless otherwise indicated.

ings Company under Section 234 in consolidated returns, even where such deductions exceeded the income of that Company, the Circuit Court of Appeals took the position "that the statutory net loss deduction was personal to the taxpayer sustaining it, could be availed of in the following year by that taxpayer alone, and by him only to the extent that he had net income in that year."[2] The learned Judge apparently means by "net income" the amount by which gross income exceeds the deductions allowable under Section 234(a) and is of the opinion that where these deductions exceed gross income there is no "net income." Since in 1927 the gross income of Piedmont Savings Company was exceeded by the deductions allowable to Piedmont Savings Company under Section 234 of the Revenue Act of 1926, the Court held that Piedmont Savings Company had no "net income" and that therefore its "net losses" for the two preceding years were not deductible and should be disregarded in the computation of consolidated net income.

Specification of Errors

1. The Circuit Court of Appeals erred in finding and holding that a statutory "net loss" (within the meaning of Section 206 of the Revenue Act of 1926) incurred by a corporation in one year (1925 and 1926), when not affiliated, may not be used to reduce consolidated net income (within the meaning of Section 240 of the Revenue Act of 1926) of an affiliated group, of which such corporation is a member, in a

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[2]The quotation is from the opinion of the Circuit Court of Appeals for the Fifth Circuit in the case of Planters' Cotton Oil Co., Inc. v. Hopkins, 53 F. (2d) 825, 826, where the Court describes its holding in the case at bar.

subsequent year (1927) in which the corporation which has sustained the "net loss" does not have gross income in excess of the deductions allowed by Section 234 (a) of the Revenue Act of 1926.

2. The Circuit Court of Appeals erred in affirming the judgment of the District Court sustaining the general demurrer to the petition.

Summary of Argument

All deductions allowable to each of the individual affiliated corporations filing a consolidated return, are allowable in computing the consolidated net income of the group, regardless of whether the deductions of an individual corporation are in excess of the gross income of that particular corporation. The Act and Regulations require the deduction of statutory "net losses" without limitation in a consolidated return just as they require the allowance of any other deduction granted to a particular corporation.

While this result seems so clearly to be required by the Statute and Regulations as not to call for any extended discussion, we have gone into an analysis of the statutory provisions at considerable length in the belief that a full discussion of the "consolidated returns" provisions and the "net loss" provisions will enable the court the more clearly to dispose of the fallacious arguments which the Government bases upon the *language* of the Statute.

After showing under Headings 1 and 2 that the result contended for by Petitioner *is required by the language* of the Statute and Regulations, we proceed to discuss under the succeeding Headings arguments of the Government and reasons advanced by the

Courts below which have no reference whatever to the *language of* the statute but are based upon supposedly "*equitable*" *considerations*. Petitioner rests its case squarely on the statute and discusses these so-called equitable considerations solely for the purpose of meeting arguments upon that basis advanced by the Government.

The argument is developed under the following Headings:

1. *General Nature and Purpose of Consolidated Returns Provisions, and the Method Provided for the Computation of Consolidated Net Income.*

2. *The Deduction Allowable under Section 206 is Allowable in Computing Consolidated Net Income upon Exactly the same Terms and to the same Extent as the Deductions under Section 234 and is not Limited by the Amount of the Income of the Corporation Previously Sustaining the "Net Loss."*

3. *That the Deduction Here Claimed is not Inappropriate to the General Scheme of the Income Tax Act is Conclusively Shown by Regulations Under the Revenue Act of* 1928.

4. *Equitable Considerations Impose no Greater Restriction upon the Deduction of "Net Losses" in Consolidated Returns than in the Return of a Single Corporation into which Another Corporation Has Been Merged.*

5. *Losses Currently Realized are Not Limited by the Commissioner in Consolidated Returns Because in Substance Suffered in Other Years or Prior to Affiliation.*

6. *Affiliation or Non-affiliation at Time Net Loss was incurred Is Immaterial.*

7. *Petitioner Does not Contend that a "Net Loss" can be Deducted in Computing a "Net Loss."*

8. *Discussion of authorities.*

Argument

1. General Nature and Purpose of Consolidated Returns Provisions, and the Method Provided for the Computation of Consolidated Net Income.

Under the Revenue Acts each corporation is a separate taxpayer and most of the provisions of the Revenue Acts relating to corporations provide for the computation of the net income of a single corporation. The provisions of the Revenue Act of 1926, so far as now material, for the computation of the net income of a single corporation, are given immediately below.

Section 232 provides what constitutes "*net income*":

> "Sec. 232. In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206 . . ."

Section 234 (a) provides:

> "Sec. 234 (a). In computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:"
>
> (There are then listed in subparagraphs 1 to 11 all deductions permitted in determining net

income except net losses brought forward from preceding years, which are covered by Section 206.)

Section 206 (a) fully defines what it designates a "*net loss*," a loss which may be carried forward from one year to another, and Section 206 (b) provides:

> "Sec. 206 (b) . . . the amount [of such "net loss"] shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year . . . and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year . . ."

The foregoing sections give the formula by which "net income" of an individual corporation, unaffiliated with other corporations, is to be computed.

It was found, however, that where the ownership of separate corporations is substantially identical it might result in great unfairness for the corporations to file separate returns and make separate tax computations as to each corporation. Since the 1918 Act, therefore, the Revenue Acts have contained provisions permitting the filing of consolidated returns by such corporations, and under the 1918 Act the Commissioner might require such corporations to file consolidated returns. Under the provisions of these returns each separate corporation remains the "taxpayer." There is no dispute between Petitioner and the Government on this point. But the income of the affiliated corporations is consolidated and *the tax is computed on this consolidated net income* as though it were the income of a single corporation.

The provisions of the 1926 Act with reference to "consolidated net income" are as follows:

> "Sec. 240 (a). Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return . . ."
>
> "(b). In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations . . ."

Article 635 of Regulations 69 provides:

> "Art. 635. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions, . . . *the consolidated taxable net income shall be the combined net income of the several corporations consolidated* . . . In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited." (Italics supplied.)

The undisputed purpose of consolidated returns is among other things: (1) the elimination of intercompany transactions, and (2) the offsetting of

losses of one corporation against the gains of another. With the exception of the "net loss" deduction it has been the universal practice of the Bureau of Internal Revenue to permit the full amount of the deductions of each corporation to be taken into consideration in computing the consolidated net income. This practice has been universal for thirteen years and is one of the advantages which has principally influenced corporations to file consolidated returns.

The practice is illustrated in the present case where the Commissioner has combined with the net income of the Petitioner amounting to $37,582.63 a minus figure of $453.80, which is the excess of Piedmont Savings Company's deductions under Section 234 (a) over its gross income.

There are two views as to the method which Article 635 of Regulations 69 prescribes for the computation of consolidated net income of affiliated corporations. We state these two methods without any effort to establish the correctness of the one rather than the other. One of the two must be correct. No other method has ever been suggested. Both reach the same result.

The more prevalent view as to the method prescribed for determination of consolidated net income is that so adequately set forth in the amici curiae brief of Mr. Robert N. Miller and Mr. John G. Buchanan and the longer amici curiae brief of Messrs. Weill, Satterlee and Lisenby. These gentlemen take the view, and very ably support it, that the net income of a consolidated group is arrived at by taking the aggregate of the gross incomes of all of the corporations affiliated, after eliminating intercompany

transactions, and then subtracting the aggregate of all of the deductions provided for the individual corporations. In this way there is no comparison between the gross income of a particular corporation and the deductions attributable to that particular corporation. We simply take the gross income of the group and subtract the aggregate of the deductions.

This is the method provided by the Regulations under the 1928 Act (which Act for present purposes is substantially identical with the 1926 Act) for the computation of consolidated net income.

Article 31 (a) of Regulations 75 under the 1928 Act provides:

> "Art. 31.—*Consolidated Net Income.* (a) *Definition.* Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as 'intercompany transactions')."

The other view is that the income of each of the affiliated corporations is determined separately after the elimination of intercompany transactions. Then when the separate income of each corporation is determined, the plus and minus figures are added together to get the net income of the consolidated group. Under this view the last clause of the first sentence of Article 635, quoted above, is taken to

mean, as it well may, that "the consolidated net income shall be the combined net *incomes* of the several corporations consolidated."

Whichever of the two views is adopted, the results are identical. It is immaterial, so far as the practical result is concerned, whether the gross incomes are added together and all the deductions then added together and subtracted, or whether the net income of each separate corporation is computed by taking the gross income of each corporation and subtracting from it the deductions of that particular corporation and then combining the plus and minus figures thus obtained.

The only difficulty with the second view is that it requires the concept of "*net income*" as a minus quantity, but that difficulty is apparent only and not real. Net income in the commercial sense may not ever be a minus quantity, but "*net income*" as used in the Revenue Acts is not commercial net income. "*Net income*" under the Act has a meaning definitely defined by the Act. Whatever it might mean generally Congress can define it as it wishes for the purpose of the Statute. It has clearly and definitely defined it in Section 232, above quoted (p. 7, *supra*). It did not see fit to define it as "commercial net income."

"*Net income*" under the Act may be, and in many instances is, altogether different from commercial net income, and may be a minus quantity when commercial net income would be a plus quantity. For example, the "*net income*" of a corporation under the Statute is computed by including in the deductions from gross income dividends received from domestic corporations [Section 234 (a) (6)], which of course

would not be deducted in computing commercial net income. A corporation might have gross income of $50,000.00, of which $45,000.00 consists of dividends from domestic corporations. It might have deductions under the other sub-paragraphs of Section 234 (a) amounting to $40,000.00. The result under the Act would be "net income" of minus $35,000.00, whereas the *commercial net income* of the corporation would be *plus* $10,000.00.

The former Secretary of the Treasury himself has recognized this obvious point that net income may be either a positive or a negative quantity. In a statement published in the Internal Revenue News (Volume 2, No. 8, page 17, February 1929), in explaining the new Regulations under the Revenue Act of 1928, Mr. Mellon stated that

> "The net income of the affiliated group is, in effect, the *algebraic* sum of the net incomes of the separate corporations in the group . . ." (Italics supplied.)

Mr. Mellon must have used the word "*algebraic*" intentionally. Its well defined meaning shows that he considered "*net income*" might be either a positive or a negative figure. (Webster's International Dictionary, "algebraical.")[3]

Yet this concept of even statutory "*net income*" as a minus quantity was one which the learned Circuit Judge would not accept for a moment. He said of it:

> "Were it not for the fact urged upon us by appellant with such earnestness that the Board of

[3]The foregoing paragraph is taken from the very excellent brief which Mr. Rollin Browne as amicus curiae has filed herein (page 7).

> Tax Appeals and the Circuit Court of Appeals for the Third Circuit have by construction found that the words in question do have the meaning which appellant contends for, we should take the simple view which Alice took before her encounter with the master logomachist, that words mean what they say, and not the opposite, and simply say, without more ado, that the words 'net income' mean net income; they do not, they cannot mean minus net income or loss." (R. 20.) 53 F. (2d) at 823.

The writer is not sufficiently versed in the political constitution of Wonderland to know just where the sovereignty there resided nor what portion of it was delegated to the master logomachist; but if the master logomachist was vested with such authority in defining the meaning of words in Wonderland as here resides in Congress in defining, for the purpose of its own enactments, terms used therein, words in Wonderland no doubt meant what the master logomachist said they should mean and not what Alice might otherwise have thought they meant.

The whole difficulty with the approach of the Circuit Court of Appeals to the question involved in this case is that it entirely ignored the fact that "*net income*" as used in the Act is precisely defined by the Act. "*Net income*" when it is defined by Congress in a Revenue Act need not mean commercial net income, or accounting net income; but it means just exactly what Congress says "*net income*" shall mean. And if within this definition it may be a minus quantity, it may be such, notwithstanding any other authority to the contrary.

Again the Circuit Court of Appeals says that the

words "net income," as used in the Revenue Act of 1926, "were used with the practical end of taxation in view, determining the amount which the taxpayer will contribute to the support of the Government in the taxable year." (R. 20.) The learned Judge indicates that the term "*net income*" as used in the Act cannot represent a minus quantity for the reason that such a minus quantity would have no practical effect in the computation of taxes. This view of the matter overlooks the fact that Section 240, relating to consolidated returns, is also an integral part of the same Revenue Act, and that a minus quantity representing the "*net income*" of an affiliate may have a most important *practical* effect upon the computation of consolidated net income and the determination of the amount of taxes to be assessed thereon. The usual provision for basing an income tax upon the "*net income*" of the single taxpayer has been superseded in the present case by the consolidated returns provision which provides for the assessment against each affiliate of its proportionate part of the total tax based upon the "consolidated net income." The practical effect of the concept of minus net income is illustrated in the case at bar where the net income of Petitioner has been reduced by the Commissioner by the sum of $453.80 from Piedmont Savings Company.

We call attention again to the fact that the concept of "*net income*" as a minus quantity is not necessary if Article 635 of Regulations 69 is construed to be equivalent to Article 31 (a) of Regulations 75 and as providing for the addition of gross incomes and the subtraction therefrom of an aggregate of the deductions. The concept of "net income" as a minus

quantity is necessary in consolidated returns only if we interpret Article 635 as requiring that the net income of each corporation is computed separately and the results combined.

But whichever of the two methods above suggested for the computation of consolidated net income is considered as required by Article 635 of Regulations 69, the Treasury Department admits that none of the deductions under Section 234 (a) is limited to the gross income of the particular corporation on whose account the deduction arose, but that each of them is deductible in full in computing the statutory "*net income*" of the consolidated group, regardless of whether they would be deductible in computing commercial income or not. In other words, the Treasury Department concedes that consolidated net income is made up in effect of the algebraic addition of the positive and negative "*net incomes*" of the members of the group where any such negative "*net income*" results from an excess of the deductions allowed in Section 234 over the gross income. In the present case the deductions allowable by Section 234 to Piedmont Savings Company in excess of the gross income of that Company amounted to $453.80 and that figure has been combined with the plus "net income" of Petitioner, whatever were the mechanics of the combination.

The only point which the Government makes is that the deduction allowable under Section 206 (b) is different in this respect from the deductions under Section 234 (a) and is limited in amount to the sum by which the gross income of the particular corporation in the taxable year in question exceeds the de-

ductions allowable to that individual corporation under Section 234 (a).

2. The Deduction Allowable under Section 206 is Allowable in Computing Consolidated Net Income upon Exactly the same Terms and to the same Extent as the Deductions under Section 234 and is not Limited by the Amount of the Income of the Corporation Previously Sustaining the "Net Loss."

Section 206 (a) provides for the determination according to clear statutory provisions of what that section designates as a "*net loss.*" That the "net loss" defined in Section 206 (a) is a statutory concept and is not to be confused with loss in general or with minus "net income" is made clear by Article 1621 of Regulations 69, which provides:

> "Art. 1621. The amount properly allowed [as a 'net loss'] may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute."

Section 206 (b) with reference to the deduction of the statutory "net losses" from gross income in succeeding years provides:

> "Sec. 206 (b). If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net in-

come for the next succeeding taxable year (hereinafter in this section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Section 232 provides in the same identical language for this deduction and the deductions provided by Section 234 (a) in the computation of net income. Section 232 makes no distinction whatever between the deductions under the two sections.

Then turning to the language of Sections 206 (b) and 234 (a) we find that they provide in substantially identical language for the deduction defined by the respective sections.

Section 234 (a) provides:

"*In computing the net income* of a corporation subject to the tax imposed by section 230 *there shall be allowed as deductions*:" [And the deductions are then listed.] (Italics ours.)

And Section 206 (b) provides that

"the amount thereof [of the 'net loss'] *shall be allowed as a deduction in computing the net income* of the taxpayer." (Italics ours.)

The Petitioner contends that without doing gross violence to the clear language of these provisions, the deductions cannot be treated differently. Both are made deductible in computing net income and one is not more or differently deductible than is the other. If one can be carried into consolidated returns to the full extent thereof, then the deductions under the other are fully deductible in a consolidated return. We have shown under Heading 1 that the deductions under Section 234 (a) are taken to the full extent thereof in consolidated returns. Consequently it is

clear that deductions under Section 206 (b) are deductible in full in a consolidated return.

The Circuit Court of Appeals (R. 22) has treated the deduction under Section 206 (b) as a *special deduction* and has stated that it is available only in strict accordance with the terms of the statute which gives it. So far as we are aware, all deductions are dependent upon the terms of the statutes which give them. We do not know how the Court can consider one deduction *special* and another *ordinary*. There is no measuring stick except the statute and that places all of the deductions upon the same basis. Under Section 234 (a) (6) dividends from domestic corporations are deductible from income. That is absolutely contrary to commercial and accounting practice. Upon what possible theory can the Court consider this as an *ordinary deduction* and consider a "net loss," brought forward from a preceding year and made deductible by the specific terms of the statute, a *special deduction?* It is true that the "net loss" arises out of transactions in a preceding year, and in this case prior to affiliation, but by the express terms of the statute it is made deductible in 1927 equally with any other deductions given by the statute.

The only argument urged with any seriousness by the Government against this view in the Circuit Court of Appeals was the following:

Section 206 (b), after providing for the deduction of a "net loss" in the second year, the year following the accruing of the "net loss," then provides:

> "and if such net loss is in excess of such net income (computed without such deduction), *the*

amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year." (Italics ours.)

The deduction—so the Government's argument runs —therefore cannot be taken in the second year in excess of the net income computed without such deduction, because the statute expressly limits the deduction of "net loss" in the second year to an amount sufficient to eliminate any plus figure resulting from subtracting from gross income the deductions provided by Section 234 (a). The Government contends that if deduction of the excess is permitted in consolidated net income in the second year, the corporation which sustained the net loss will still be entitled to the deduction from its net income in the third year, and there will result therefore a double deduction, which, it is argued, is clearly contrary to the intent of the statute.

There are at least two answers to this argument:

First. The simplest answer is that we are here concerned with the "*third year*" and not with the "*second year,*" and there is no provision in Section 206 (b) which can possibly be held to limit the deduction in the "*third year*"; and there is no provision for carrying the "net loss" forward further against the net income of the particular corporation sustaining the "net loss" and there is no possibility of any double deduction.[4] It will be recalled that the big

[4]The argument which might be advanced to the effect that it is unreasonable to assume that Congress intended such a "net loss" to be deductible in the "third year" on a different basis than in the "second year" is sufficiently disposed of by the reasoning of the Court in Burnet v. Moore Cotton Mills, 49 F. (2d) 59 (C. C. A. 4th, 1931).

"net loss" sustained by the Piedmont Savings Company in this case was sustained in 1925 in the sum of $43,478.25 and the total consolidated taxable net income of the group in 1927, which is the year in question, computed without the benefit of this deduction, amounts to only $36,133.82, so that it is immaterial for the purposes of this case whether the "net loss" of $410.82 sustained by the Piedmont Savings Company in 1926 is held to be deductible or not.

Second. The Government's argument is unsound because it fails to take into consideration the limitations placed upon the carrying forward of net losses of an individual corporation by its consolidation with other corporations who in effect are given the benefit of a loss in a consolidated return. Section 206 (b) does not as a matter of fact provide that only such portion of the "net loss" as shall be necessary to eliminate the net income computed without the benefit of the "net loss" shall be deducted in the second year. It provides that the "net loss" shall be deducted in computing net income for the second year, but it goes ahead and provides that where a full benefit is not received from this loss because of the smallness of the taxpayer's income in the second year it may be carried forward to the third year. But naturally where the full benefit of the loss has been received in a consolidated return it may not be carried forward and taken again. The Government's argument, if carried to its logical conclusion, would lead to an absurd result for which the Bureau of Internal Revenue has never contended. Consider the following situation:

Corporations A and B are consolidated for 1926.

Corporation A has gross income in excess of all deductions amounting to $50,000.00. Corporation B sustains in its 1926 operations a loss of $50,000.00, arising in such manner as to make it a "net loss" within the provisions of Section 206. Naturally, however, the $50,000.00 loss of B is offset against the $50,000.00 gain of A resulting in consolidated net income of zero. Now under the literal language of Section 206 (b) this "net loss" of B is deductible in computing the net income of B in 1927. We do not believe this Court would sustain the allowance of this deduction in 1927. If we should be wrong, and if the Court should sustain such a deduction, it would simply result in a double deduction. Certainly no one would contend that the losses of B currently happening in 1926 when the corporations were consolidated could not be offset against the gains of A in that year. The Bureau of Internal Revenue has always permitted the deduction of these items in consolidated returns, regardless of whether the deductions would constitute a "net loss" if the corporation sustaining the deductions were standing alone. To hold the contrary would be to subordinate the very important consolidated returns provisions of the statute to an entirely strained construction of the net loss provisions of the statute. And yet such a construction of the statute which would prevent the deduction of current losses in a consolidated return—because they are of the sort which Section 206 (b) provides that an unaffiliated corporation carry forward as a "net loss" to the "*second year*"—would be no less unreasonable than is the Government's argument in this case to the effect that the "net loss" of Piedmont Savings Company cannot be taken in a consolidated return in

the "*second year*" because Section 206 (b) provides that it shall be carried forward to the "*third year.*"[6]

While the argument above referred to was the argument most strenuously urged, and in fact the only argument seriously urged, by the Government in presenting this case before the Circuit Court of Appeals, it was in no way relied upon by the Circuit Court of Appeals and that Court did not even see fit to mention it in its opinion.

The only other argument on the language of the statute which even superficially has the slightest shadow of plausibility in it is the argument that, since Section 206 (b) provides for the deduction of a "net loss" in the second and third year in computing the net income of the "*taxpayer,*" it is therefore *personal* to the particular corporation which sustained it. A comparison of Section 234 (a) with Section 206 (b) will show conclusively that such a contention is absolutely without merit.

Section 234 (a) states that the deductions therein provided shall be used "in computing the net income of a *corporation subject to the tax imposed by Section 230.*" Section 206 (b) permits the deduction "in

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[6]See the discussion of this matter on pages 8 and 9 of the amicus curiae brief of Mr. Rollin Browne. Cf. Kaiwiki Sugar Co., 21 B. T. A. 997. In this case part of a corporation's net loss went to wipe out the income of an affiliate in a consolidated return. In the succeeding year the corporation suffering the net loss was no longer affiliated and sought to apply the full amount of the net loss against its income for that year. The Commissioner urged and the Board properly held that the part of the net loss which was used to reduce consolidated net income to zero in the prior year could not be again taken as a net loss by the corporation sustaining it.

computing net income of the *taxpayer*." But Section 206 (b) is dealing with both individual and corporate taxpayers. Section 234 (a) on the other hand is dealing only with the corporations subject to the tax imposed by Section 230. "Taxpayer" is not a more limited term, as this argument suggests, but is a more general term than, and includes, "corporations subject to the tax imposed by Section 230." But the important point is that in each case the section permitting the deductions is referring to a single legal entity, and this is just as much true of the one as of the other.

It would be very fanciful to say that the deduction allowed by Section 206 (b) to a "*taxpayer*" is personal to a particular corporation, but that the deductions allowed by Section 234 (a) to a "*corporation subject to the tax imposed by Section 230*" are not personal to the particular corporation, so that the latter may be taken into a consolidated return and be taken advantage of by the group to a greater extent than the former. One is no more personal than the other. Each is personal if the particular section granting it is read alone, but neither is purely personal when read in the light of the consolidated returns provisions, as they must be.

It is submitted that under the clear general terms of Sections 232, 234, 206 and 240 and Article 635 of Regulations 69, there is absolutely no basis for treating the deduction allowed by Section 206 (b) differently from the deductions allowed by Section 234 (a) in computing consolidated net income. If there were any extrinsic reason to suppose that Congress intended to exclude one kind of deduction in

consolidated returns, an answer would be found in a fundamental principle of statutory construction. For, in Section 240, relating to consolidated returns, Congress has *expressly* limited the use of the *specific credit* authorized by Section 236 (a) in the case of a domestic corporation. In view of the express limitation on the use of the *specific credit* of individual corporations in consolidated returns, and in view of the failure of the Act to limit in any way the use of any *deductions* of individual corporations in consolidated returns, it must be concluded that no limitation was intended on the use of such deductions in consolidated returns. *Expressio unius est exclusio alterius.*

The Circuit Court of Appeals, however, apparently realizing that it could not rest its decision on the language of the Act, seeks to support its decision by relying upon principles not expressed in the statute but derived by the Court from sources unknown to us. We believe the error into which the Court has fallen shows as clearly as anything could how very dangerous it is for a Court in construing a legislative enactment, and especially a taxing statute—instead of relying upon the language of the Act before it—to rely upon its own concepts of the most appropriate result to be obtained.

3. That the Deduction Here Claimed is not Inappropriate to the General Scheme of the Income Tax Act is Conclusively Shown by Regulations Under the Revenue Act of 1928.

But the reason upon which the Circuit Court of Appeals seemed most strongly to rely in refusing to allow the deduction in this case is that it would be "generally inappropriate to the Federal scheme of

income taxation, designed as it is with the sole exception of the statutory net loss provision, to make each person subject to the tax, pay taxes on his income for the year in which it accrues." (R. 19.)

The District Court was of the opinion that it "would not be in line with, but antagonistic to, the intent of and the reasons for the law" permitting consolidated returns to hold that an affiliated group could take advantage of the net loss occurring prior to affiliation to an extent greater than the income of the corporation which sustained the net loss. (R. 9-10.)

That the Courts were entirely in error as to Petitioner's claim being inappropriate to the general scheme of taxation is clearly shown by the Regulations under the 1928 Act which cover by specific terms, and not merely by general language, the exact situation which here exists. Article 41 (c) of Regulations 75 provides:

> "Art. 41 (c). *Net Loss Sustained by Separate Corporation prior to Consolidated Return Period.* A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

Regulations 75 were promulgated under the Revenue Act of 1928. They are expressly made applicable only to 1929 and subsequent years. (Regulations 75, page 358.) These Regulations therefore do not in any way cover the present case and we are not even referring to them for the purpose of construing the language of earlier Acts and Regulations. *We refer to them here for one purpose alone, and that is for the purpose of showing that the result for which we here contend is not inappropriate to the general scheme of income taxation.* The first time the Commissioner of Internal Revenue and the Secretary of the Treasury ever adverted specifically to this situation in exercising their regulation making power, they permitted exactly what Petitioner now claims. This would seem to show, as clearly as anything could, that there is nothing unreasonable in the result.

It will certainly not be seriously contended that the general scheme of income taxation under the 1926 and 1928 Acts is so different as to make the result for which we here contend unreasonable under the former when it is expressly permitted under the latter. There is some difference in the requirements necessary to constitute affiliation, and the regulation making power of the Commissioner is somewhat broader under the later Act; *but the general character of consolidated returns and the principle of computing net income on a yearly basis* remains the same, and the material language of the "net loss" sections is identical.

It will be noted in Article 41 (c) of Regulations 75, quoted above, that there is a limitation placed on the deduction of a "net loss" happening prior to affiliation in the following language:

"but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

It is very significant that this limitation applies only in case the affiliation took place after January 1, 1929, and *it is the limitation, and not the general allowance of the deduction in a consolidated return, that is removed where the affiliation took place prior to January 1, 1929.*

It is interesting too to note what the Treasury Department did when it finally sought by regulations under the 1928 Act to limit net loss deductions occurring prior to affiliation in order to prevent unfair use being made of such deductions by the affiliated group. It did not adopt a limitation which in any way resembles the limitation which the Government now urges. The Government's contention here is that the net loss shall be used in the consolidated return only to the extent of what the plus "net income" of the particular corporation would be computed without the "net loss deduction."[6] Regulations 75, on the other hand, limit the *amount of the usable net loss* and provide *no restriction* as to the *income against which* the "net loss" may be used. The limitation is that the *usable amount* of the net loss shall not exceed the cost or other basis of the stock of the company suffering such loss. *The question whether the net loss*

[6]This limitation was adopted by the Circuit Court of Appeals for the Fifth Circuit. See the language of that Court in its opinion in Planters' Cotton Oil Company v. Hopkins, quoted supra, page 4, in which the Court described its holding in the case at bar.

company has income or loss is entirely immaterial. The allowable "net loss" is limited to the cost of the stock of the net loss company, *even though the separate income of that company is greater than such cost;* and such amount of net loss is deductible, *even though that company had no income.*

Although the Regulations under the 1928 Act were expressly called to the attention of the Circuit Court of Appeals in two briefs and in oral argument as showing clearly that the District Court was in error in assuming that the result for which the Petitioner contends is out of keeping with the general scheme of income taxation, the Circuit Court of Appeals in its opinion does not even refer to the 1928 Act or to Article 41 (c) of Regulations 75.

4. Equitable Considerations Impose no Greater Restriction upon the Deduction of "Net Losses" in Consolidated Returns than in the Return of a Single Corporation into which Another Corporation Has Been Merged.

It is believed that the Circuit Court of Appeals, in imposing a limitation on the use of a "net loss" deduction (which it does not impose on the use of any other deduction) in consolidated returns, has acted on the view that some such limitation is necessary to prevent an unjust use of the net loss deduction through affiliation. The real reason for the decision of the Circuit Court of Appeals is summarized in the following language from its opinion:

> "On the face of it, a ruling which permits a corporation with a consistent record of gains, to affiliate with one having a large accumulation of statutory net losses for the purpose and with the result of using these losses in the year of affiliation as deductions from its income in that

year, appears generally inappropriate to the Federal scheme of income taxation, designed as it is with the sole exception of the statutory net loss provision, to make each person subject to the tax, pay taxes on his income for the year in which it accrues." (R. 19) 53 F. (2d) at 823.

The District Court in the case at bar acted on the same considerations (R. 9-10) 44 F. (2d) at 857.

With this apparent evil before it, the Circuit Court of Appeals felt compelled to impose a restriction upon the use of "net loss" deductions in consolidated returns by prohibiting the use of such "net loss" deductions to reduce below zero the income of the corporation sustaining the "net loss." As we have previously attempted to show, the imposition of such a limitation is entirely beyond the province of the Court and the result obtained by following Petitioner's view certainly does not require the imposition of limitations not provided by the Statute.

Exactly the same results, to avoid which the Circuit Court of Appeals has written an exception into the Statute, may be accomplished without resort to consolidated returns, and by a method as to which there can be no legal dispute. Thus if we can imagine a designing corporation looking for "net losses" to buy up or deal in (if there be any such corporation) it need not *simply affiliate* with a corporation having a "large accumulation of net losses" with the view to getting the benefit of the net loss deductions in a consolidated return. All that is necessary is *to merge* the prosperous business with the net loss corporation under the charter of the latter.

Then there will be no question of a consolidated re-

turn, and the results which the Government seeks to avoid by construction of the consolidated return provisions are just as easily accomplished. The single corporation which sustained the "net loss" prior to merger continues as the same taxpayer and will simply carry its "net loss" of the preceding year into its return for the year following the merger. Since the results which the Circuit Court of Appeals sought to avoid can so easily be accomplished without resort to consolidated returns, will the Government contend that some further limitation is to be imposed on the "net loss" deductions in situations like the one suggested where consolidated returns are not involved?

5. Losses Currently Realized are Not Limited by the Commissioner in Consolidated Returns Because in Substance Suffered in Other Years or Prior to Affiliation.

The Government has urged that the "net loss" deductions authorized by Section 206 are to be distinguished from the other deductions authorized by Section 234 (a) under the circumstances of the present case. The only basis suggested for such distinction is that the "net loss" deductions pertain to prior years whereas the deductions under Section 234 (a) are "current." The Court below attempted to state the basis of this discrimination thus:

> "We think the assumption of appellant and its argument in support of it overlooks the point that taxes go by years, and that though in the taxable year in question the individual corporations are still taxpayers, the business is really regarded for the purpose of taxation, as a unit, and as such subject to tax on the business of that year. Because the income on which the tax shall be paid in the taxable year, though

made up of the results of the business of each affiliate, is not the income of each individual taxpayer, but the income of the unit for that year, the Commissioner was right in allowing against the aggregate gross income of the business for that year the *aggregate deductions applicable to that year.*" (Italics ours.) (R. 22.) 53 F. (2d) at 824.

But the Circuit Court of Appeals has not shown that the "net loss" deductions available to Piedmont Savings Company by reason of the "net losses" incurred in 1925 and 1926 are not *applicable* to 1927. *Under the express terms of Section* 206 (b) *these net loss deductions are made "applicable to that year."* It matters not that the circumstances and events which gave rise to the deductions occurred in prior years, perhaps prior to affiliation. Under the Statute the benefit of the deductions was to be reaped in 1927. The mere fact that the principal circumstances or events which gave rise to the deduction occurred prior to affiliation does not afford a basis of discrimination by excluding such deduction in the computation of consolidated net income for the year in which the statute makes that deduction applicable.

Suppose that the excess of Piedmont Savings Company's deductions under Section 234 (a) over its gross income for 1927, namely the sum of $453.80 (R. 3), was due entirely to a loss on the sale of properties which Piedmont Savings Company had acquired years before, and prior to affiliation. The deduction for such a loss is made applicable to the year 1927, under the terms of the statute, even though the depreciation in values occurred long before then. Would the Circuit Court of Appeals hold

that this is a loss purely personal to the corporation sustaining it, having no reasonable connection with the current business of the affiliated group for 1927? Would the Circuit Court of Appeals exclude such a deduction from the consolidated returns for 1927, on the theory that a "ruling which permits a corporation having a consistent record of gains, to affiliate with one having a large accumulation of" depreciated investments which could be sold at tremendous losses, "with the result of using these losses in the year of affiliation as deductions from its income in that year, appears generally inappropriate to the Federal scheme of income taxation"?[7]

No one has ever suggested that an affiliated group may not deduct the full amount of losses which a member corporation has thus suffered from the sale of investments which had depreciated prior to affiliation, even where such losses exceed the gross income of the member suffering them.

Other examples besides those given under this and the preceding headings may be thought of which will illustrate the point which we are urging: namely, that it is utterly unreasonable to hold that the Commissioner is given power in any case arbitrarily to determine, upon the basis of his understanding of the Congressional intent and appropriateness to the general scheme of Federal taxation, whether a particular deduction is to be allowed in the computation of consolidated net income. Results under the consoli-

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[7]Cf. the language quoted from the opinion of the Circuit Court of Appeals, pp. 29, 30, supra.

dated returns section and the Regulations thereunder, as under other provisions of the Revenue Acts, are to be determined by language of the statute and Regulations and not by considerations of "equity."

6. Affiliation or Non-affiliation at Time "Net Loss" Was Incurred Is Immaterial.

There is absolutely nothing in the language of the statute which would warrant or even suggest a distinction in the present case if Piedmont Savings Company and Petitioner had been affiliated in 1925 and 1926 when the net losses in question occurred. The contentions of the Government, as set forth under Heading 2 above, if held to prevent the deduction sought in the present case, would apply equally though the Piedmont Savings Company and Petitioner had been affiliated throughout the years 1925, 1926 and 1927. It is impossible to distinguish the two cases on the language of any of the provisions in the statute or regulations relating to consolidated returns or to "net losses."

Counsel for Respondent at the argument before the Circuit Court of Appeals admitted frankly that affiliation or non-affiliation at the time the net loss occurred was immaterial so far as any argument of the Government was concerned. It is presumed that the Solicitor General will make the same admission before this Court. In any event, the Bureau of Internal Revenue has taken the position that the same rules are applicable to both cases. G. C. M. 8132, IX—1 C. B. 287.

The Circuit Court of Appeals, however, in its opinion in the present case seized upon the so-called

"equities" of the situation and laid great stress upon the fact that Piedmont Savings Company and Petitioner were not affiliated when the "net losses" occurred. This consideration had also largely influenced the District Court in reaching a conclusion adverse to Petitioner. A few days after the decision in the present case the Circuit Court of Appeals for the Fifth Circuit was presented with a situation where the "equities" were exactly the same as though legal affiliation had existed throughout the entire period. See *Planters Cotton Oil Co. v. Hopkins*, 53 F. (2d) 825. The Court then ignored the "equities" and held still that the "net loss" could not be deducted to an extent greater than the income of the corporation which sustained it and said that this result was required by the language of the statute. In that case the Court seemed to rely principally upon the argument that the "net loss" deduction is a deduction personal to the "taxpayer" which sustained it; ignoring entirely the fact that Sections 206 (b) and 234 (a), when read out of connection with the consolidated returns provisions, are applicable only to the single taxpayer which sustained the deductions provided.

7. Petitioner Does not Contend that a "Net Loss" can be Deducted in Computing a "Net Loss."

A patently fallacious argument has been urged by the Government in several of its briefs on this subject and misled the District Court in this case and the Circuit Court of Appeals in the case of *Commissioner v. Ben Ginsburg Co.*, 54 F. (2d) 238 (C. C. A. 2nd, 1931). This is the argument to the effect that the treatment of "net loss" for which Petitioner here contends would result in allowing a "net loss" for one year to be taken into consideration in computing a

"net loss" for the succeeding year. Of course a "net loss" from one year cannot be used in determining a "net loss" in a succeeding year. "Net loss" even more clearly, if possible, than "net income" is a creature of statute. Not all net losses commonly so called are "net losses" under the statute.[8] Section 206 provides just what deductions are to be taken in computing a "net loss." A "net loss" from a preceding year is not among the deductions provided in this section. So, of course, it cannot be deducted. But this has no bearing upon the question as to whether it can be deducted in computing "net income" so as to give a minus figure to go into consolidated "net income." "Net income," when a minus quantity, is not in any sense under the statute synonymous with "net loss." Dividends received from another corporation cannot be deducted in computing a "net loss" to be carried forward [Section 206 (a) (4)], but no one would have the temerity to suggest that they may not be deducted in the computation of corporate "net income," even though the result may be to create a minus quantity to be carried into a consolidated return.

Of course if the proper method of computing "consolidated net income" is to take the aggregate of the gross income minus the aggregate of the deductions, a "net loss" is not used to produce a minus quantity for any purpose, and therefore no one would even sug-

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[8]Reg. 69, Art. 1621 . . . In order to be entitled to claim an allowance for a 'net loss' the taxpayer must have suffered an actual net loss in a trade or business during the taxable year. The amount properly allowed may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute . . ."

gest that a "net loss" is being used in the computation of a "net loss."

8. State of the Authorities.

The question involved in this case has been before three Circuit Courts of Appeals in four cases.[9] The Third Circuit has decided in favor of the taxpayer. The Second and Fifth Circuits have decided against the taxpayer. Two District Courts have considered the question and they have decided against the taxpayer.[10]

The Board of Tax Appeals at first sustained the Government's position.[11] However, when the matter was more fully presented to the Board of Tax Appeals, it overruled its earlier decision and held in a long line of cases in favor of Petitioner's position.[12]

However, after the decision in the present case and the decision in the Circuit Court of Appeals for the

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[9]National Slag Co. v. Commissioner, 47 F. (2d) 846, (C. C. A. 3rd, March 3, 1931); Commissioner v. Ben Ginsburg Co., 54 F. (2d) 238 (C. C. A. 2nd, Nov. 2, 1931); Woolford Realty Co. v. Rose, 53 F. (2d) 821 (C. C. A. 5th, Nov. 13, 1931); Planters Cotton Oil Co., Inc. v. Hopkins, 53 F. (2d) 825 (C. C. A. 5th, Nov. 20, 1931). The cases in this footnote and the footnote following are sufficiently discussed in the body of the brief.

[10]Woolford Realty Co. v. Rose, 44 F. (2d) 856 (N. D. Ga., Nov. 14, 1930); Planters Cotton Oil Co., Inc. v. Hopkins, 47 F. (2d) 659 (N. D. Tex., Mar. 2, 1931).

[11]Alabama By-Products Corp., 16 B. T. A. 1073; National Slag Company, 16 B. T. A. 1310.

[12]Alabama By-Products Corp., 18 B. T. A. 919; Ginsburg Co., 19 B. T. A. 81; Buckie Printers' Ink Co., 19 B. T. A. 943; Pittsburgh Gasoline Co., 21 B. T. A. 297; General Box Corporation, 22 B. T. A. 725; Arrow Coal & Ice Company, 22 B. T. A. 1341; Tolerton & Warfield Company, 23 B. T. A. 892; Hawley Investment Company, 23 B. T. A. 953; Milgrim & Bros., Inc., 24 B. T. A. 853; Smalls, Inc., 24 B. T. A. 686; Summerfield Co., 24 B. T. A. 829.

Second Circuit in the *Ginsburg* case (note 9 *supra*), the same question again came before the Board in a case which was appealable to the Circuit Court of Appeals for the Second Circuit, and the Board of Tax Appeals reversed its previous position and held in favor of the Commissioner.[13]

Great reliance was placed below upon the case of *Swift & Company v. United States*, 38 F. (2d) 365 (Ct. Cls. 1930) and on the case of *Sweets Co. v. Commissioner*, 40 F. (2d) 436 (C. C. A. 2nd 1930). Both of these cases are authority for the proposition that a corporation in an affiliated group remains the taxpayer, and that the group is not a taxpayer. We have no quarrel with this proposition and have assumed its soundness throughout our brief. Beyond this proposition the *Sweets Company* case has no bearing whatever upon the present question.

In the *Swift & Company* case one of the questions involved was the right to use in the consolidated returns of an affiliated group for 1918 the full amount of a net loss suffered by one of the members of the group in 1919. The case turned upon a proper construction of Section 204 (b) of the Revenue Act of 1918 which provided that where "a taxpayer has sustained a net loss" for a year prior to January 1, 1920, "the amount of such net loss shall . . . be *deducted from the net income* of the taxpayer for the preceding taxable year." The Court of Claims held that under this statutory provision the amount of the "net loss" incurred by one member of the group in 1919 could be used in the consolidated returns for 1918 only to the extent of wiping out the net income, for 1918, of the particular corporation sustaining the

[13]Bowman Hotel Corp., 24 B. T. A. 1193.

"net loss." It will be noticed that the pertinent language of Section 204 (b) of the Revenue Act of 1918 which was the subject of construction in the *Swift* case is substantially different from the language of Section 206 (b) of the Revenue Act of 1926 which is involved in the case at bar.

In the present case, instead of providing that the "net loss" shall "be *deducted from the net income of the taxpayer*," the statute here involved provides that the amount of the "net loss" "shall be allowed as a deduction *in computing the net income of the taxpayer*." This difference in the wording of these two statutory provisions has been held to afford a substantial legal distinction. Cf. *Warren-Nash Motor Company*, 21 B. T. A. 897 with *Alabama By-Products Company*, 18 B. T. A. 919. And see the well written opinion of Judge Coleman in the case of *Burnet v. Moore Cotton Mills*, 49 F. (2d) 59 (C. C. A. 4th, 1931). The approach to a question of statutory construction of the Circuit Court of Appeals for the Fourth Circuit in the case last cited is in striking contrast with the approach of the Circuit Court of Appeals for the Fifth Circuit in this case, and in the case of *Planters Cotton Oil Company v. Hopkins*.

None of the other authorities cited by the Courts below or by the Government in its briefs have any bearing upon the question here involved and for that reason it is not felt necessary to discuss them.

Conclusion

Under Headings 1 and 2 above we believe we have shown beyond the possibility of doubt that the language of the statute and regulations requires the

result for which we contend. The Petitioner rests its case squarely upon the plain and unambiguous language of the Revenue Act of 1926 and the Regulations thereunder, which clearly require a decision in Petitioner's favor.

If it should be conceded that the slightest ambiguity exists, it would not be necessary to call the Court's attention to the rule requiring all provisions of Revenue Acts—including those relating to *deductions* and even provisions thereof constituting statutes of limitations against the Government—to be construed most strictly in favor of the taxpayer.[14]

We have gone into the so-called "equities" of the situation not because we feel that they should have any bearing upon the situation in view of the clear and unambiguous language of the statute and regulations, but only because the Government and the Court below have been so impressed by supposed "equities" and imaginary "evils."

Respectfully submitted,

W. A. SUTHERLAND,
Counsel for Petitioner
Atlanta, Georgia

Of Counsel:
ELBERT P. TUTTLE,
JOSEPH B. BRENNAN,
Atlanta, Georgia

April, 1932.

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[14]Bowers v. New York & Albany Lighterage Company, 273 U. S. 346, 350 (1927); United States v. Updike, 281 U. S. 489, 496 (1930); Crooks v. Harrelson, 282 U. S. 55, 61 (1930); Burnet v. Niagara Falls Brewing Co., 282 U. S. 648.

APPENDIX

Statutes and Regulations Involved

Revenue Act of 1926, Section 232:

In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, . . .

Revenue Act of 1918 (c. 18, 40 Stat. 1057), Section 232:

That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234 . . .

Revenue Act of 1926, Section 234(a):

In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

[There are then listed, under sub-paragraphs (1) to (11), all deductions permitted in determining net income, except "net losses" brought forward from preceding years, which is covered by Section 206. The deductions listed under Section 234(a) include ordinary and necessary expenses, interest and taxes paid, losses sustained, bad debts, dividends from domestic corporations, depreciation, obsolescence and depletion.]

Revenue Act of 1926, Section 206(a) and (b):

(a). As used in this section the term "net

loss" means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations:

(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

(2) In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;

(3) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to paragraph (2) of subdivision (c) of section 204;

(4) The deduction provided for in paragraph (6) of subdivision (a) of section 234 of amounts received as dividends shall not be allowed;

(5) There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234.

(b). If, for any taxable year, it appears upon the production of evidence satisfactory to the

Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1061), Section 204(b):

(b). If for any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be *deducted from the net income of the taxpayer for the preceding taxable year;* and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of Section 252. If such net loss is in excess of the net income for such preceding taxable year, *the amount of such excess shall* under

regulations prescribed by the Commissioner with the approval of the Secretary *be allowed as a deduction in computing the net income for the succeeding taxable year.* (Italics ours.)

Revenue Act of 1926, Section 240(a) and (b):

(a). Corporations which are affiliated within the meaning of this section may, for any taxable year make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b). In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236.

Regulations 69, Article 635:

Consolidated net income of affiliated corporations.—Subject to the provisions covering the determination of taxable net income of separate

corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. Only one specific credit of $2,000, as provided in section 236 (b) and article 591, shall be allowed the consolidated group; and this only in case the net income of the group does not exceed $25,000; but if such net income is more than $25,000, the tax imposed by section 230 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000. In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

Revenue Act of 1928, Section 117(a) and (b):

[Section 117 (a) of the Revenue Act of 1928 *defines* "net loss" under the 1928 Act and does not differ in any way here material from Section 206 (a) of the Revenue Act of 1926, page 41, supra. Section 117 (b) with reference to the *deduction* of "net losses" is *identical* with Section 206 (b) of the Revenue Act of 1926, page 42, supra.]

Revenue Act of 1928, Section 141(a), (b) and (c):

(a) *Privilege to file consolidated returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) *Regulations.*—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(c) *Computation and payment of tax.*—In any case in which a consolidated return is made the tax shall be determined, computed, assessed,

collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the date on which such return is made. Only one specific credit computed as provided in section 26 (b), shall be allowed in computing the tax.

Regulations 75, Article 31(a) (Under Revenue Act of 1928):

Definition.—Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as "intercompany transactions").

Regulations 75, Article 41(c) (Under Revenue Act of 1928):

Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.—A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corpora-

tion; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group.

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No. 582

In the Supreme Court of the United States

October Term, 1931

WOODLAND REALTY COMPANY, INC., PETITIONER

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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Bowman Hotel Corporation v. *Commissioner*, 24 B. T. A., decided December 19, 1931 — 4

Commissioner v. *Ben Ginsburg Company* (C. C. A. 2d), decided November 2, 1931, reported in Prentice-Hall Federal Tax Service (1931), Vol. 1, p. 2300.107 — 4

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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 582

WOOLFORD REALTY COMPANY, INC., PETITIONER

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

We do not oppose the instant petition.

OPINIONS BELOW

The opinion of the District Court (R. 8–10) is reported in 44 F. (2d) 856. The opinion of the Circuit Court of Appeals (R. 17–24) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 13, 1931. (R. 25.) Petition for a writ of certiorari was filed December 21, 1931. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the statutory net losses of a corporation, sustained in 1925 and 1926, when not affiliated with the petitioner, may be set up as a deduction under the Revenue Act of 1926 in a consolidated income tax return for 1927, when the corporation was affiliated with the petitioner and had no net income.

STATUTE AND REGULATIONS INVOLVED

The applicable statute and regulations are set forth in the Appendix to the petition, pp. 23–26.

STATEMENT

The District Court for the Northern District of Georgia sustained (R. 10) a demurrer to a petition in a suit to recover income taxes and interest (R. 5) paid by petitioner for 1927. The petition set forth the following facts (R. 2–6):

Petitioner corporation owned 96 per centum of the capital stock of the Piedmont Savings Company during 1927, and the two companies filed a consolidated income tax return for the calendar year 1927, showing net taxable income to petitioner of $37,582.63 and a loss to the Piedmont Savings Company of $453.80, and a combined net taxable income for the consolidated group of $37,128.53 (R. 3), upon which a tax with interest thereon was paid (R. 5).

Petitioner and the Piedmont Savings Company filed an amended consolidated income tax return

in May, 1928, claiming an additional deduction in the computation of the 1927 tax for the net losses sustained by the Piedmont Savings Company of $43,478.25 and $410.82, during the years 1925 and 1926, respectively. (R. 4.) This claim was denied by the Commissioner of Internal Revenue. (R. 5.)

The petition did not allege facts showing that the two corporations were affiliated prior to 1927 and the petition for certiorari concedes that they were not.

The Circuit Court of Appeals affirmed the judgment of the District Court. (R. 17–25.)

DISCUSSION

The decision of the court below in the instant case seems to conflict with that of the Circuit Court of Appeals for the Third Circuit in *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846. Although it is possible to distinguish the two cases upon the facts, we believe that they are contrary in principle. In the instant case there was no affiliation of the two corporations until the taxable year involved. In the *National Slag Co.* case, one of the affiliated corporations was not incorporated until the taxable year, but it continued an unincorporated business which had been owned by the individual who during the taxable year owned at least 95 per centum of the voting stock of each of the two corporations. Although the Circuit Court of Ap-

peals in the instant case said that the *National Slag Co.* case "did not decide the point before us" (R. 24), it refused to follow the *National Slag Co.* case in a later case involving a situation practically identical with that presented in that case. *Planters Cotton Oil Co., Inc.*, v. *Hopkins, Collector,* decided November 20, 1931, reported in Prentice-Hall Federal Tax Service (1931), Vol. 1, Par. 2123.

The decision in the instant case is in accord with that of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Ben Ginsberg Co., Inc.,* decided November 2, 1931, reported in Prentice-Hall Federal Tax Service (1931), Vol. 1, Par. 2021. The Board of Tax Appeals has twice changed its position on the question here involved. Its latest opinion followed the decision in the instant case. *Bowman Hotel Corporation* v. *Commissioner,* 24 B. T. A. — (decided December 19, 1931). In *Alabama By-Products Corporation* v. *Commissioner,* 18 B. T. A. 919, it changed its previous view, under which it had denied a deduction in situations similar to that here presented.

Although the cases mentioned arise under several different revenue acts, the provisions of most of the tax acts involved are identical.

In view of the uncertainty in the authorities, and particularly the apparent conflict between the decision in the instant case and that of the Circuit

Court of Appeals for the Third Circuit in *National Slag Co.* v. *Commissioner, supra,* we do not oppose the petition.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
CLAUDE R. BRANCH,
SEWALL KEY,
JOHN R. MCEVERS,
Special Assistants to the Attorney General.
WILLIAM H. RILEY, Jr.,
Attorney.

JANUARY, 1932.

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No. 582

In the Supreme Court of the United States

OCTOBER TERM, 1931

WOODWARD REALTY COMPANY, INC., PETITIONER

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the United States District Court for the Northern District of Georgia (R. 8–10) is reported in 44 F. (2d) 856. The opinion of the Circuit Court of Appeals (R. 17–24) is reported in 53 F. (2d) 821.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 13, 1931. (R. 24.) The petition for certiorari was filed December 21, 1931, and granted January 25, 1932. Jurisdiction is conferred upon this Court by Section 240 (a) of the

Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether under Section 206 of the Revenue Act of 1926 petitioner may deduct from its gross income for 1927, when it was affiliated with the Piedmont Savings Company and for which year the two companies filed a consolidated income-tax return, net losses sustained by the Piedmont Company in 1925 and 1926, when the two companies were not affiliated, despite the fact that the Piedmont Company had no net income for the year 1927.

STATUTES AND REGULATIONS INVOLVED

These will be found in the Appendix, *infra,* pp. 33–41.

STATEMENT

Petitioner brought this suit in the United States District Court for the Northern District of Georgia to recover $5,026.22 (R. 3), representing income taxes and interest paid by petitioner for the year 1927 (R. 5). The petition set forth the following facts:

In the years 1925 and 1926 the Piedmont Savings Company sustained net losses of $43,478.25 and $410.82, respectively. (R. 4.) Petitioner concedes that it was not affiliated with the Piedmont Company in those years. (Pet. 3; Pet. Br. 13.)

During 1927 petitioner owned 96% of the capital stock of the Piedmont Company. The two companies filed a consolidated income tax return for

that year showing net taxable income to petitioner of $37,582.63 and a loss to the Piedmont Company of $453.80, making a combined net taxable income for the consolidated group for 1927 of $37,128.83, upon which a tax was paid. (R. 3.)

In May, 1928, petitioner and the Piedmont Company filed an amended consolidated income tax return, claiming as additional deductions in the computation of their net income for 1927 the net losses sustained by the Piedmont Company in 1925 and 1926. (R. 4.) The claim was denied by the Commissioner of Internal Revenue (R. 5), and this suit followed. A demurrer to the petition was sustained by the District Court. (R. 8–10.) Judgment was entered dismissing the petition (R. 10), which was affirmed by the Circuit Court of Appeals for the Fifth Circuit (R. 17–25).

SUMMARY OF ARGUMENT

A taxpayer has no right to any deductions from gross income except as created by statute. Section 206 of the Revenue Act of 1926 provides that if any taxpayer has sustained a net loss, it "shall be allowed as a deduction in computing the net income ~~for that year~~ of the taxpayer for the succeeding taxable year"; and if the net loss is in excess of the net income "computed without such deduction," the excess "shall be allowed as a deduction in computing the net income for the next succeeding taxable year." Since the privilege thus accorded is in the nature of an exemption from the ordinary scheme of taxation, which is on the basis of an an-

nual accounting of the business transactions for the taxable year, it should not be extended by implication, and any doubt as to the extent of the privilege should be resolved in favor of the normal mode of taxation.

Our position is that availability of the deduction under Section 206 is restricted to the elimination of the net income of "the taxpayer," and if "the taxpayer" has no net income for the taxable year, a net loss of the preceding year must be carried forward to the next succeeding taxable year. Such is the express mandate of the statute, and the rule established by the cases.

Petitioner's contention that "net income" may be a minus quantity and that the net loss deduction may therefore be taken even though the sum of "the taxpayer's" deductions under Section 234 is in excess of gross income runs counter to the common understanding of the word "income." Moreover, in the case where the net loss of the preceding year exceeds the net income of the taxable year computed without the net loss, petitioner's contention would lead to the inclusion in the sum which Section 206 (b) directs to be carried forward to the next succeeding year of items which Section 206 (a) directs shall not be so included. No such inconsistency appears when net income is interpreted in accordance with common understanding as meaning a positive sum.

Since the Piedmont Savings Company had no net income for 1927, it could not deduct its net losses of 1925 and 1926 in 1927. As the Piedmont Com-

pany could not make the deduction, neither could petitioner, it being settled that the affiliated group may not in a consolidated return take a deduction not available to the member corporations. Hence an affiliated group may take advantage of net losses suffered by a member before affiliation only to the extent that the member had net income for the taxable year for which the consolidated return is filed.

There is no inconsistency between this position and the fact that all the deductions under Section 234 may be taken upon the filing of a consolidated return regardless of whether the individual corporations had net income. Section 234 has no provision, like that of Section 206 (b), for carrying forward to the next succeeding taxable year the sum by which the deduction exceeds the net income calculated without such deduction; and the fair implication from Section 240 authorizing the filing of a consolidated return of net income, is that all the items of gross income and deduction resulting from the operation of two corporations as a business unit in the taxable year should be listed on the consolidated return. This implication does not extend to the deduction of net losses sustained by a member before affiliation, except in so far as expressly authorized by Section 206 (b).

Our assumption that "the taxpayer" referred to in Section 206 (b) is the Piedmont Company is justified by the language of Section 206 (b) and (c), and the definition of "taxpayer" in Section 2. It is well settled that each of the affiliated corpora-

tions filing a consolidated return remains "the taxpayer" and that the group is merely a tax computing unit, not the taxable unit.

In two respects the purpose of Section 240, under which the consolidated return was filed, militates against the result sought by petitioner. Congress sought to prevent tax evasion by Section 240. If petitioner's contention be sustained, this Court would sanction the tax-evading practice by which a corporation earning a large net income purchased for a nominal consideration the stock of a corporation which had a large net loss for the preceding year, filed a consolidated return, and secured a large reduction in tax by means of the affiliation. Although affiliated corporations are now allowed the benefit of net losses sustained by a member corporation before affiliation, even though the latter has no net income for the taxable year for which the consolidated return is filed, tax evasion of the kind described is prevented by the restriction that the amount of such net loss may not exceed the cost to the purchasing corporation of the stock of the corporation which had suffered the net losses. Furthermore, the main object of Section 240 was to require taxes to be levied according to the true net income resulting from a single business enterprise, even though carried on through more than one corporation. In the present case petitioner and the Piedmont Company were not operated as a business unit until 1927, when they became affiliated. It would not effectuate the main purpose of Section 240 to permit petitioner to take advantage of net

losses sustained by the Piedmont Company before the two corporations were operated as a business unit.

The Government's position is sustained by the weight of authority, the Court of Claims and the Circuit Court of Appeals for the Second Circuit, as well as that for the Fifth, having adopted its view. The decision of the Circuit Court of Appeals for the Third Circuit to the contrary is unsound and should be disapproved. The Board of Tax Appeals, after some vacillation, has finally adopted the Government's position.

If the statute is doubtful or uncertain, it should be interpreted in the light of the consistent practical application given it by the officers charged with its administration, who have always taken the view which we urge here. Such interpretation is entitled to great weight and should not be disturbed unless clearly erroneous.

Petitioner can secure no aid from Treasury Regulations 75, which permit the deduction sought here. They are expressly made applicable only to 1929 and subsequent years, and were promulgated under the Revenue Act of 1928, which was expressly made applicable only to 1928 and subsequent years, and which changed considerably the provisions relating to consolidation and broadly authorized the Commissioner to make regulations with respect to the tax liability of affiliated corporations. So far from helping petitioner, the Act of 1928 would seem, impliedly at least, to recognize that a different rule had prevailed until then.

ARGUMENT

PETITIONER WAS NOT ENTITLED TO DEDUCT FROM ITS GROSS INCOME FOR 1927 THE NET LOSSES SUSTAINED BY THE PIEDMONT SAVINGS COMPANY IN 1925 AND 1926 WHEN THE TWO COMPANIES WERE NOT AFFILIATED

It is settled that a taxpayer has no right to any deductions from gross income except as authority for such deductions is given by statute. *Burnet* v. *Thompson Oil Co.*, 283 U. S. 301, 304; *Darby-Lynde Co.* v. *Commissioner*, 51 F. (2d) 32, 33 (C. C. A. 10th), certiorari denied, 284 U. S. xvii; *Pugh* v. *Commissioner*, 49 F. (2d) 76, 77 (C. C. A. 5th), certiorari denied, 284 U. S. xii; *Consolidated Gas Co.* v. *United States*, 65 C. Cls. 252, 259, certiorari denied, 278 U. S. 612; *New Creek Co.* v. *Lederer*, 295 Fed. 433, 435 (C. C. A. 3rd), certiorari denied, 265 U. S. 581; *Kentucky Tobacco Products Co.* v. *Lucas*, 5 F. (2d) 723, 728 (W. D. Ky.); *Planters' Cotton Oil Co.* v. *Hopkins*, 53 F. (2d) 825, 826 (C. C. A. 5th), certiorari granted March 21, 1932. Petitioner apparently does not contend that any statute or Treasury regulation expressly authorizes the deduction claimed in the present case, but relies on an interpretation of Sections 206 and 240 of the Revenue Act of 1926 as furnishing implied authority for it. Subsection (b) of Section 206 (*infra* p. 34) provides:

> If, for any taxable year, * * * any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in

> computing the net income of the taxpayer for the succeeding taxable year * * *, and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year * * *; the deductions in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.[1]

This provision must be read in the light of the well-known fact, recently commented on by this Court, that the normal mode of computation for income-tax purposes is on the basis of an annual accounting of the business transactions during the taxable year. In *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, this Court said (pp. 363, 364–365):

> All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. Under Sections 230, 232, and 234 (a) of the Revenue Act of 1918, 40 Stat. 1057, respondent was subject to tax upon its

[1] Section 206 (a), *infra*, p. 34, defines "net loss" as the excess of the deductions allowed by Section 234 over the gross income, with several exceptions. Section 234, *infra*, p. 36, permits the deduction of specified items, not including net losses sustained in earlier years, in the computation of the net income of a corporation.

annual net income, arrived at by deducting from gross income for each taxable year all the ordinary and necessary expenses paid during that year in carrying on any trade or business, interest and taxes paid, and losses sustained, during the year. * * *

* * * * * *

* * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or a loss.

The Sixteenth Amendment was adopted to enable the Government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the Government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. It is not suggested that there has ever been any general scheme for taxing income on any other basis. The computation of income annually as the net result of all transactions within the year

> was a familiar practice, and taxes upon income so arrived at were not unknown, before the Sixteenth Amendment. * * *

See also *Kansas City Southern Ry. Co.* v. *Commissioner,* 52 F. (2d) 372, 376, certiorari denied, 284 U. S. —, November 30, 1931.

In accordance with the practice thus indicated, deductions are normally restricted to the taxable year to which they are properly allocable. Section 234 of the Revenue Act of 1926, *infra* p. 36. In asserting the right to deduct the Piedmont Company's net losses for 1925 and 1926 in 1927, petitioner is seeking a privilege which is an exception to the general mode of tax computation and its right to which must therefore be conferred in clear and unmistakable terms. If there is any doubt, it should be resolved in favor of the normal method of tax computation. "The intent to exclude must be definitely expressed, where * * * the general language of the Act laying the tax is broad enough to include the subject matter." *Choteau* v. *Burnet,* 283 U. S. 691, 696. See also *Bowers* v. *Lawyers Mortgage Co.,* 285 U. S. —, decided March 14, 1932; *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232, 235; *Cornell* v. *Coyne,* 192 U. S. 418, 431; *Swan & Finch Co.* v. *United States,* 190 U. S. 143, 146; *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, 146; *Phipps* v. *Bowers,* 49 F. (2d) 996, 998 (C. C. A. 2d), certiorari denied, 284 U. S. xi, October 19, 1931; *Insurance & Title Guarantee Co.* v. *Commissioner,* 36 F. (2d) 842, 844 (C. C. A. 2d), certiorari denied,

281 U. S. 748; *Green's Advertising Agency* v. *Blair*, 31 F. (2d) 96, 98 (C. C. A. 9th); *Basham Co.* v. *Lucas*, 21 F. (2d) 550, 551 (W. D. Ky.), affirmed, 30 F. (2d) 97 (C. C. A. 6th); *Hubbard-Ragsdale Co.* v. *Dean*, 15 F. (2d) 410, 412 (S. D. Ohio), affirmed, 15 F. (2d) 1013 (C. C. A. 6th).

We submit, therefore, that the privilege granted by Section 206 (b), being in the nature of an exemption from the regular scheme of taxation, should not be extended by implication. Our position is that the privilege of deduction of net losses of earlier years is limited to the elimination of "the net income of the taxpayer * * * computed without such deduction"; and if "the taxpayer" has no net income computed without such deduction, these net losses may not be availed of in that taxable year but must be carried forward to the next succeeding year. Such is the express mandate of the statute. *Supra*, p. 9.

Petitioner contends that the "net income" referred to in Section 206 may be a minus quantity and that therefore the deduction may be taken even though "the taxpayer's" deductions under Section 234 are in excess of the gross income. We submit that Congress could not have intended a meaning so repugnant to the common understanding of the word "income." Compare *McCaughn* v. *Hersey Chocolate Co.*, 283 U. S. 488, 491–492. Petitioner's construction would lead to results plainly contrary to the expressed intent of Congress. To illustrate: Suppose corporation A suffered a net

loss of $5,000 in 1925 and that its deductions under Section 234 for 1926 exceeded its gross income for that year by $1,000. According to petitioner's contention, corporation A's net income for 1926 would be the sum of minus $6,000. Section 206 (b) directs that when the net loss for the preceding year ($5,000) is in excess of the net income computed without such deduction (minus $1,000), the excess shall be carried forward to the next succeeding year. Now the sum by which $5,000 exceeds the sum of minus $1,000 is $6,000. Hence, if petitioner's contention be sound, the sum of $6,000 may, under Section 206 (b), be carried forward to 1927 to be used as a deduction in the computation of net income for that year. If we assume that the $1,000 sum was made up of deductions which under Section 206 (a) are to be excluded in the computation of statutory net loss, the result of petitioner's construction is that sums which Section 206 (a) excludes from the amount of deductible net loss are by Section 206 (b) made deductible. No such inconsistency appears when "net income" is construed, in accordance with the common understanding, ~~sense~~, as meaning a positive sum, since in such case only the $5,000 would be carried forward to 1927.

The Government's position that the deduction under Section 206 is restricted to the elimination of net income is supported by the decisions in *Commissioner* v. *Ben Ginsburg Co.*, 54 F. (2d) 238, 239 (C. C. A. 2d); *Planters' Cotton Oil Co.* v. *Hopkins*, *supra*, 53 F. (2d) 825, 826.

In the present case the Piedmont Company is "the taxpayer" referred to in Section 206. (See argument *infra,* pp. 17–18.) It had no net income in 1927. Hence it could not avail itself in that year of the net losses it had sustained in 1925 and 1926. The statute permitted the 1926 net loss to be carried forward to 1928 to be used in the computation of net income, if any, for that year. The 1925 net loss, however, could not be so carried forward since the privilege of postponement expired in 1927. (See Section 206 (b), *supra,* pp. 8–9.) But that fact can not alter the result. Since the congressional intent to restrict the availability of the net loss deduction to the two succeeding years is clear,[2] any supposed hardship is immaterial. As the Circuit Court of Appeals for the Second Circuit said in *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, 240:

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[2] Compare the report of the Senate Committee in charge of the Revenue Act of 1924, which reads in part (Senate Report No. 398, 68th Congress, 1st Session, p. 20):

> This subdivision [Sec. 206 (b)] corresponds to section 204 [b] of the existing law. It should be noticed that in the bill it is provided that the amount of the net loss shall be used as a deduction in computing net income for the succeeding taxable years; it is not allowable, however, as a deduction in computing the net loss of the succeeding taxable year, since to do this would allow the benefits of the net loss to be taken not only in the two succeeding taxable years but for an indefinite time until it was absolutely wiped out.

The Treasury Regulations issued pursuant to the provisions of Section 206 provide (Art. 1622 of Reg. 69, *infra,* p. 40):

> The income tax law has defined net income and provides the formula for its computation, and has defined net loss and prescribed the formula for its computation; these formulae are exclusive. *Botany Worsted Mills* v. *United States,* 278 U. S. 282. The congressional intent is plain, and it is the duty of the courts to give effect thereto. *United States* v. *Goldenberg,* 168 U. S. 95.

As the Piedmont Company could not deduct its 1925 and 1926 net losses in 1927, petitioner must fail. It is well settled that the affiliated group may not take a deduction in the consolidated return which is not available to the particular member corporations. *First National Bank* v. *United States,* 283 U. S. 142; *Swift & Co.* v. *United States,* 38 F. (2d) 365, 375 (n. 2), 377 *et seq.* (C. Cls.), affirmed on another point, 282 U. S. 468; *Commissioner* v. *Ginsburg Co.; supra,* 54 F. (2d) 238, 239, 240. Article 635 of Treasury Regulations 69, *infra,* p. 39, dealing with the calculation of consolidated net income, is expressly made *"subject to the provisions covering the determination of taxable net income of separate corporations."* (Italics ours.) It follows that corporations filing a consolidated return for a given taxable year may take advantage of net losses sustained by a member of the group before affiliation only to the extent that the member has net income for that year; and

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It should be noticed, however, that a "net loss" for a preceding year may not be considered in computing a "net loss" for a succeeding year.

for the reasons stated "net income" necessarily means an amount greater than zero.

We find no inconsistency between this position and the fact, urged by petitioner, that all the deductions under Section 234, *infra,* p. 36, may be taken upon the consolidated return regardless of whether the particular corporations had net income. There is no provision in Section 234, as there is in Section 206(b), to the effect that the deductions should be carried forward to the next succeeding year if in excess of gross income. As a matter of practice the taxpayer would list all its deductions under Section 234 even though in excess of gross income in order to protect itself in case some of the deductions should be disallowed. But, as we have attempted to demonstrate, *supra,* pp. 12–13, before the net loss deduction may be claimed, it must be ascertained whether there is any net income computed without the net loss. If not, the deduction may not be taken, but must be carried forward. See Article 1622 of Treasury Regulations 69, *infra,* p. 40. Article 635 of Treasury Regulations 69, *infra,* p. 39 clearly contemplates that each of an affiliated group of corporations will list all its available deductions on the consolidated return, and that the net income of the affiliated group taxed by Section 240, *infra,* p. 36, will be ascertained by deducting from the aggregate gross income the aggregate of the deductions allowable to the particular corporations. Indeed, this is the only way in which the intent of Congress to treat as a business unit that which is operated as such could be at-

tained. Thus the fair implication is that Congress intended to authorize such a method of computing the taxable income of the group. But it would be quite contrary to the purpose of recognizing the group as a business unit to permit petitioner to benefit from losses sustained by the Piedmont Company before the two corporations were operated as such. See *infra*, pp. 20–21. The business unity of the group is not to be affected by echoes of the previous failures of its constituent parts.

We have proceeded on the assumption that "the taxpayer" which may deduct the net loss under Section 206(b) is the Piedmont Company and that "the taxpayer" does not mean the group composed of affiliated corporations. On its face the language of the section would seem to require that construction, since the words "the taxpayer" obviously refer to that "taxpayer" which has suffered the net loss—here the Piedmont Company. Section 2 of the Revenue Act of 1926, *infra, p.* 34, supports this conclusion by defining "taxpayer" as "any *person* subject to a tax imposed by this Act" and "person" as (among other things) "*a* corporation." Strong evidence that "the taxpayer" was intended to have only this meaning is to be found in Section 206(g), *infra,* p. 35, extending the benefit of the section to the members of a partnership and to an estate or trust. *Expressio unius est exclusio alterius.*

Petitioner and Piedmont filed their consolidated return for 1927 under Section 240 of the Revenue

Act of 1926, *infra*, p. 36, subsection (b) of which provides:

> In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. * * *

There is nothing to countenance the view that the affiliated group becomes "the taxpayer" within Section 206. The effect of the filing of the consolidated return is merely to make the affiliated group a tax *computing* unit. The group does not itself become the taxable unit. The tax is assessed "upon the respective affiliated *corporations.*" It is well settled that the members of the group remain the "taxpayers." *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365, 374, 375, 376; *Sweets Co.* v. *Commissioner,* 40 F. (2d) 436, 438 (C. C. A. 2d); *Beneficial Loan Soc.* v. *United States,* 48 F. (2d) 686, 687 (C. Cls.), certiorari denied, 284 U. S. x, October 19, 1931; *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, 239; *Fire Companies Bldg. Corp.* v. *Commissioner,* 54 F. (2d) 488, 489 (C. C. A. 2d); *Hoffman* v. *United States,* 52 F. (2d) 269, 270 (W. D. Mo.); *Hart Glass Mfg. Co.* v. *United States,* 48 F. (2d) 435, 441–442 (C. Cls.).

A basic reason for the enactment of Section 240 was to prevent tax evasion. The Senate Commit-

tee on Finance, in proposing the section, said (Senate Report No. 617, 65th Congress, 3d Session, p. 9):

> So far as its immediate effect is concerned consolidation increases the tax in some cases and reduces it in other cases, but *its general and permanent effect is to prevent evasion which can not be successfully blocked in any other way.* (Italics ours.)

See also *Handy & Harman* v. *Burnet,* 284 U. S. 136, 141.

If petitioner's argument as to the application of the provisions for consolidated returns is justified, a device designed to prevent tax evasion is converted into a vehicle for the evasion which Congress sought to prevent. If, for example, corporation A earning a large net income purchased for a nominal consideration all the stock of corporation B which had suffered a large net loss the preceding year, they could, if petitioner's contention be adopted, file a consolidated return deducting the net loss of the preceding year, even though corporation B had no net income during the period of affiliation. In this way corporation A could secure a large reduction in tax by means of affiliation and accomplish the very result which Congress desired to eliminate. The affiliation provisions were obviously not designed to permit tax evasion by the purchase and sale of tax losses. While such evasion became impossible on January 1, 1929,[8] the number of reported

[8] When the regulations were changed on January 1, 1929, pursuant to statutory authorization, so as to permit affiliated

decisions dealing with similar attempts to evade suggests the existence of a large number of transactions of the type described which occurred before that date, the effectiveness of which for taxation purposes will turn on the decision in the present case. Intent to prevent such a result is also to be found in Article 634 of Treasury Regulations 69, *infra* p. 39, dealing with changes in affiliation during the taxable year, which indicates a purpose to exclude separate businesses from the consolidated return by requiring separate returns for the portions of the year during which there was and was not affiliation. See also *Sweets Co.* v. *Commissioner, supra,* 40 F. (2d) 436.

There is another reason why petitioner is not aided by Section 240. As this Court has recently declared, the primary purpose of the consolidated return provision was to require taxes to be levied according to the true net income resulting from a single business enterprise, even though it was conducted by means of more than one corporation. *Handy & Harman* v. *Burnet, supra,* 284 U. S. 136, 140. In the present case, petitioner and the Piedmont Company were not operated as a business unit until 1927, when they

---

corporations to deduct net losses suffered by a member corporation before affiliation even though it had no net income for the taxable period, careful provision was made to prevent tax evasion of the kind described in the text by limiting the amount of the deductible net loss to the cost to the affiliated group of the stock of the member which had suffered the net loss. This was an effective remedy for the evil of using the affiliation provisions for the barter of tax liability. See argument, *infra*, pp. 29–32.

became affiliated. Before that time Piedmont had suffered the net losses which petitioner seeks to deduct. To permit petitioner to take advantage of the net losses sustained by Piedmont before the two corporations were operated as a business unit not only would not effectuate the main purpose of Section 240, but would violate the rule that deductions are normally personal to the taxpayer suffering them and may not be availed of by another. *Busch* v. *Commissioner*, 50 F. (2d) 800 (C. C. A. 5th); *Planters' Cotton Oil Co.* v. *Hopkins, supra*, 53 F. (2d) 825. We submit that the purpose of Section 240 as well as the language of Section 206(b) require the construction urged by the Government.

The Government's position is sustained by authority. The Circuit Court of Appeals for the Second Circuit and the Court of Claims, as well as the Circuit Court of Appeals for the Fifth Circuit, have reached the conclusion for which we contend. In *Swift & Co.* v. *United States, supra*, 38 F. (2d) 365, 375 n. 2, 377 *et seq.*, the Court of Claims had before it Section 204 (b) of the Revenue Act of 1918, *infra*, p. 33, which allowed a taxpayer to deduct its net loss for a given year from its net income for the *preceding* year. A corporation which became a member of an affiliated group in 1919 sustained a net loss in that year. The affiliated corporations sought to deduct this loss in computing their 1918 taxes. In the course of a careful opinion the Court of Claims said (p. 379):

> Of course this net loss will not be used in the consolidated computation for 1918 for the reason that this corporation was not a member of the 1918 group * * *.

Footnote 3 on pages 378–379 of the opinion [38 F. (2d)] contains an illuminating discussion of the problem in the present case. The court says (p. 378):

> Corporation E's [the corporation which was a member of the affiliated group in 1919 but not in 1918] net loss would, of course, not affect the consolidated net income computation in 1918, for the reason that it was not a member of the affiliated group, and the company did not exist in the group to which the net loss might be applied.

The *Swift* case was approved by the Circuit Court of Appeals for the Second Circuit in *Sweets Co.* v. *Commissioner, supra,* 40 F. (2d) 436, which also dealt with Section 204 (b) of the Revenue Act of 1918. There a Virginia corporation was affiliated with two other corporations until October 31, 1919, but not for the remaining two months of the calendar year 1919. In the period ending October 31, 1919, the affiliated group as a whole had net income, none of which was attributable to the Virginia corporation. One of the contentions was that the net loss of the Virginia corporation suffered during the last two months of the calendar year should be used as a deduction from the income of the affiliated group. The court said (p. 439):

> The Virginia corporation having had no income during the period ending October 31, 1919, we need not consider section 204 (b), for, even if it were construed to be applicable, the Virginia corporation could gain no benefit *from crediting its losses of the last two months against its income of the prior period.* (Italics ours.)

In *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, the Circuit Court of Appeals for the Second Circuit considered the identical question presented here, and, following the decision of the Court of Claims in *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365, and its own decision in *Sweets Co.* v. *Commissioner, supra,* 40 F. (2d) 436, denied the claim of the taxpayer.

The Circuit Court of Appeals for the Fifth Circuit followed its decision in the present case in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* 53 F. (2d) 825. The District Courts in the present case (R. 8–10) and the *Planters' Cotton Oil* case, 47 F. (2d) 659 (N. D. Tex.), reached the same result.

The only court decision to the contrary is that of the Circuit Court of Appeals for the Third Circuit in *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846. The facts in that case, as revealed by the findings of the Board of Tax Appeals, 16 B. T. A. 1310, are as follows: John M. Buckland owned practically all the stock of a railroad company. He also owned and operated a business which he incorporated on January 1, 1924, as the National Slag Company, owning practically all its stock. The railroad

company suffered net losses in 1922, 1923, and 1924. The Slag Company had net income for 1924. The two companies filed a consolidated return for 1924, and the question was whether the railroad's net losses for 1922 and 1923 could be deducted. The fact that the same person was the beneficial owner of both enterprises during the years involved seems to have had an important bearing upon the court's decision. The court gave very little consideration to the statutory provisions, but concluded (p. 847):

> In view of the fact that Buckland owned both companies before and after incorporation of the slag company, it seems *on principle* that the provisions of section 206 should apply to the consolidated return of these affiliated companies. The return of these companies should be treated as an economic unit, and not as separable into various component parts, or individual returns. * * * That one of these instrumentalities forming one of the component parts in the consolidated return was not incorporated until after the losses sought to be deducted were sustained, does not make the provisions *on principle* inapplicable to the return, for it was in fact the same instrumentality, but acting in 1924 through corporate forms. (Italics ours.)

It is difficult to determine what the court meant by the words "on principle." If there is any room for the application of "principle" in the interpretation of Section 206, it should be in the direction of literal construction for the reasons we have stated,

supra, pp. 9–12. While the *Slag Company* case was slightly different from the present case in that one man owned both businesses *before* as well as during affiliation, the Circuit Court of Appeals for the Fifth Circuit held the fact variation immaterial in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* 53 F. (2d) 825, which applied the rule of the instant case to facts closely similar to those in the *Slag Company* case. The Circuit Court of Appeals for the Second Circuit has also refused to follow the *National Slag Company* case. *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, 240. We submit that the decision in the *Slag Company* case is unsound.

The Board of Tax Appeals after some vacillation has finally adopted the view urged by the Government. In *Alabama By-Products Corp.* v. *Commissioner,* 16 B. T. A. 1073, the Board dealt with Section 204 of the Revenue Act of 1918, *infra* p. 33, and took the position for which we contend. It lucidly expressed its interpretation of the statute as follows (pp. 1078–1079):

> Since, under the statute, each member of an affiliated group is a "taxpayer" and the relief granted by section 204 is given to "any taxpayer," it is our opinion that an affiliated corporation, which suffered a net loss in 1919, prior to the beginning of the period of affiliation, and which net loss exceeded the amount of its net income for 1918, is entitled to deduct the excess of such net loss from its individual net income for 1920, and

> to that extent the consolidated net income is thus reduced.
>
> However, if the corporation which sustained the net loss in 1919 has no individual net income for 1920, the excess of such net loss over its 1918 net income may not be taken as a deduction, for the reason that such taxpayer has no income from which it can be deducted, and a net loss sustained by one taxpayer may not be deducted from the net income of another taxpayer or group of taxpayers, even though it be an affiliated corporation and included in a consolidated return with another or other corporations.

This decision was followed in *National Slag Co.* v. *Commissioner, supra,* 16 B. T. A. 1310, under Section 206 (b) of the Revenue Act of 1924, which was identical with Section 206 (b) of the Act of 1926, *infra* p. 35, involved in the present case. On rehearing, the Board (two members dissenting) reversed its decision in the *Alabama By-Products* case and announced that the *National Slag* case was overruled. 18 B. T. A. 919. The reversal was predicated on a supposed difference in meaning between the first and second clauses of Section 204 (b) of the Act of 1918, one of which provided that the net loss should be "deducted from the net income" and the other that it should be "allowed as a deduction in computing the net income." See also *Burnet* v. *Moore Cotton Mills Co.*, 49 F. (2d) 59 (C. C. A. 4th).[4] In *Warren-Nash Motor Corp.* v. *Commis-*

[4] The petitioner in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* which is to be argued immediately after this case,

sioner, 21 B. T. A. 897, where the Board was dealing with Section 204 of the Act of 1921, *infra* p. 33, it said that the clause in issue was the one providing that the net loss should be "deducted from the net income," and that therefore (p. 900):

> Following the principle of the *Alabama By-Products Co.* case, the net loss sustained in 1922 is deductible by the corporation which sustained that loss from its net income of the first succeeding taxable year, that is, 1923, to the extent of that net income. Since, in the first succeeding taxable year the deduction may not exceed the net income of that year, there being no net income, there may be no deduction.
>
> We, therefore, agree with the respondent that the deduction in 1923 is allowable only to the extent that the Nash-Newark Co., which sustained the net loss in 1922, had net income in 1923. Since it had no net income in 1923, there is no basis for the deduction claimed by the petitioner in that year.

After the decision of the court below and the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Ginsburg Co., supra,* 54 F. (2d) 238, the Board of Tax Appeals, without citing its earlier decisions, adopted the construction which we urge. *Bowman Hotel Corp.* v. *Commissioner,* 24 B. T. A. 1193, 1209–1210.

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contends that this supposed difference in meaning throws light upon the question presented here. Assuming that there is a difference in meaning which has validity in cases like *Burnet* v. *Moore Cotton Mills Co., supra,* we submit that it has none here.

The consistent administrative interpretation of Section 206 and its earlier prototypes is in accord with the Government's position in the instant case. In 1924, the Solicitor of Internal Revenue took our view. Law Opinion No. 1113, Cumulative Bulletin, III–2, p. 36, 42. The relevant portion of this opinion appears in footnote 2, p. 375, of *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365. In 1928, the General Counsel of the Bureau of Internal Revenue, in General Counsel Memorandum No. 3266, VII–1 C. B. 205, approved the Solicitor's opinion, and in 1930, in Memorandum No. 8132, IX–1 C. B. 287, he accepted the decision of the Court of Claims in *Swift & Co.* v. *United States, supra,* 38 F. (2d) 365. He restated his conclusions to the same effect in Memorandum No. 8618, IX–2 C. B. 180. See also Memorandum No. 8686, IX–2 C. B. 306.

The Commissioner did not acquiesce in the *Alabama By-Products* case, see IX–2 C. B. 67, nor in the following decisions which applied it. *Buckie Printers' Ink Co.* v. *Commissioner,* 19 B. T. A. 943, nonacquiescence in X–1 C. B. 76; *Pittsburgh Gasoline Co.* v. *Commissioner,* 21 B. T. A. 297, nonacquiescence in X–1 C. B. 90; *General Box Corp.* v. *Commissioner,* 22 B. T. A. 725, nonacquiescence in X–1 C. B. 80; *Arrow Coal & Ice Co.* v. *Commissioner,* 22 B. T. A. 1341, nonacquiescence in Int. Rev. Bull., Vol. X, No. 40, p. 1; *Tolerton & Warfield Co.* v. *Commissioner,* 23 B. T. A. 892, nonac-

quiescence in Int. Rev. Bull., Vol. XI, No. 4, p. 2; *Hawley Investment Co.* v. *Commissioner*, 23 B. T. A. 953, nonacquiescence in Int. Rev. Bull., Vol. XI, No. 3, p. 2.

If it be considered that Section 206 is ambiguous or uncertain, then we submit that the consistent practical application given it by the officers charged with its enforcement is entitled to great weight and should not be disturbed unless clearly erroneous. *Universal Battery Co.* v. *United States*, 281 U. S. 580, 583; *Brewster* v. *Gage*, 280 U. S. 327, 336; *Swendig* v. *Washington Co.*, 265 U. S. 322, 331; *Logan* v. *Davis*, 233 U. S. 613, 627.

Petitioner cites Treasury Regulations 75. (Br. 13, 14.) They do not aid it. By express provision they are applicable only to 1929 and subsequent years. (See *infra*, p. 41.) Regulations 75 were promulgated under the Revenue Act of 1928, c. 852, 45 Stat. 791. That Act has no application to the years now in question. The Committees which drafted the Act substantially rearranged the provisions of earlier Acts and were impressed with the necessity of making a fresh start. House Report No. 2, 70th Congress, 1st Session, p. 11; Senate Report No. 960, 70th Congress, 1st Session, p. 17. For that reason the provisions of the income tax title of the Act were made applicable only to 1928 and subsequent years. Section 1, *infra*, p. 37. The Senate Committee on Finance said with reference

to the provisions of the Act (Senate Report No. 960, 70th Cong., 1st sess., p. 18):

> They have no effect whatsoever on taxes imposed for prior taxable years, nor do the provisions of the 1926 income tax title have any effect on the computation of tax for 1928 or later years. For this reason the income tax title of the 1926 Act is not repealed by the bill and remains in force for the collection of taxes for 1925, 1926, and 1927 * * * [with exceptions not here material].

See also the statement of the managers of the bill on the part of the House, House Report No. 1882, 70th Congress, 1st Session, p. 10.

The consolidated return provisions of the Revenue Act of 1928 are appreciably different from those of the former Acts. Section 141 (d), *infra* p. 38, restricts affiliation to the case of "one or more chains of corporations connected through stock ownership with a common parent corporation." Section 141 (b), *infra* p. 38, authorizes the Commissioner, with the approval of the Secretary, to "prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted *in such manner as clearly to reflect the income and prevent avoidance of tax liability.*" (Italics ours.) The import of this authority,

under which the Commissioner promulgated Article 41 (c), *infra*, p. 41, is reflected in the report of the managers of the bill on the part of the House, House Report No. 1882, 70th Cong., 1st sess., p. 16, where it is said:

> Among the regulations which it is expected that the commissioner will prescribe are: * * * (3) the extent to which and the manner in which net losses sustained by a corporation before it became a member of the group shall be deducted in the consolidated return * * *.

Thus it is apparent that Congress specifically granted to the Commissioner authority to permit and control deductions of the kind involved in the present case. Section 141 of the 1928 Act provides a new basis for the filing of consolidated returns and a new scheme for the taxation of affiliated corporations. The regulations promulgated under it have no bearing upon the question in this case, and they certainly can not be treated as an administrative construction of the earlier and unlike statutory provisions, for the administrative construction of those Acts, as reflected in the Commissioner's action in the present case, was quite different. The present regulations, issued under the new statutory authority, effectively prohibit the acquisition of net losses through the purchase for a nominal sum of the stock in a corporation which suffered them, by destroying the incentive for such acquisition solely for tax purposes. But the statutes with which we

are now dealing did not permit the use of net losses by an affiliated group under the circumstances of this case at all, and regulations similar to those now in force were neither necessary nor authorized by law. The present regulations are based on a statute which, impliedly at least, recognized that a different rule had prevailed until then. *Brewster* v. *Gage, supra,* 280 U. S. 327, 337.

CONCLUSION

It is respectfully submitted that the decision of the court below is correct and should be affirmed.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
WHITNEY NORTH SEYMOUR,
SEWALL KEY,
JOHN H. MCEVERS,
Special Assistants to the Attorney General.
WILBUR H. FRIEDMAN,
Attorney.

APRIL, 1932.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

The Revenue Act of 1918 provided in part as follows (c. 18, 40 Stat. 1057, 1061):

> SEC. 204 (b). If for any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year; and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. If such net loss is in excess of the net income for such preceding taxable year, the amount of such excess shall under regulations prescribed by the Commissioner with the approval of the Secretary be allowed as a deduction in computing the net income for the succeeding taxable year.

The Revenue Act of 1921 provided in part as follows (c. 136, 42 Stat. 227, 231):

> SEC. 204 (b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory

to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such suceeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Section 206 (b) of the Revenue Act of 1924 (c. 234, 43 Stat. 253, 260) was identical with Section 206 (b) of the Act of 1926, *infra*, p. 35.

The Revenue Act of 1926 provided in part as follows (c. 27, 44 Stat. 9, 17, 41, 46):

SEC. 2 (a). When used in this Act—

(1) The term "person" means * * * a corporation.

* * * * *

(9) The term "taxpayer" means any person subject to a tax imposed by this Act.

NET LOSSES

SEC. 206 (a). As used in this section the term "net loss" means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations:

(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

* * * * *

(3) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to paragraph (2) of subdivision (c) of section 204;

(4) The deduction provided for in paragraph (6) of subdivision (a) of section 234 of amounts received as dividends shall not be allowed;

(5) There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234.

(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * * *

(g) The benefit of this section shall be allowed to the members of a partnership, to an estate or trust, * * * under regulations prescribed by the Commissioner with the approval of the Secretary.

NET INCOME OF CORPORATIONS DEFINED

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206 * * *.

* * * * * *

DEDUCTIONS ALLOWED CORPORATIONS

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

(2) All interest paid or accrued within the taxable year on its indebtedness * * *;

(3) Taxes paid or accrued within the taxable year * * *;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *;

(5) Debts ascertained to be worthless and charged off within the taxable year * * *;

* * * * * *

CONSOLIDATED RETURNS OF CORPORATIONS

SEC. 240. (a) Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such re-

turn. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. * * *

Section 117 (b) of the Revenue Act of 1928 (c. 852, 45 Stat. 825) was identical with Section 206 (b) of the Act of 1926, *supra*, p. 35. The Act of 1928 also provided (45 Stat. 791, 831):

Sec. 1. Application of Title.

The provisions of this title shall apply only to the taxable year 1928 and succeeding taxable years. * * *

SEC. 141. Consolidated Returns of Corporations—1929 and Subsequent Taxable Years.

(a) *Privilege to file consolidated returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated

return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) *Regulations.*—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

* * * * * *

(d) *Definition of "affiliated group."*—As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other corporations.

As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(e) A consolidated return shall be made only for the domestic corporations within the affiliated group. * * *

Treasury Regulations 69 promulgated under the Revenue Act of 1926 provide in part as follows:

ART. 634. *Change in ownership during taxable year.*—(a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the parent or principal corporation, under the conditions described in (a) above, should file a consolidated return including the income of such subsidiary or subordinate corporation to the date of the change of stock ownership, and each should file a separate return from the date of such change in stock ownership to the end of the taxable period, and, under the conditions described in (b) above, each corporation should file a separate return from the beginning of the taxable period to the date of the change in stock ownership, and a consolidated return should be filed by the parent or principal corporation from the date of change of stock ownership to the end of the taxable year, including therein the income of the subsidiary or subordinate corporation for such period.

ART. 635. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of inter-

company transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. * * * In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

ART. 1622. *Claim for allowance of net loss.*—A taxpayer sustaining for any taxable year a "net loss" as defined in section 206 (a) and article 1621 may file a claim therefor with his return for the succeeding taxable year (referred to in article 1623 as the "second year"): The claim should contain a concise statement setting forth the amount of the net loss and all pertinent facts relative thereto, including a schedule showing the computation of the net loss in accordance with section 206 and articles 1621 and 1626. If the evidence furnished satisfies the Commissioner that the taxpayer has sustained a "net loss," the amount of such net loss may be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year, and if such net loss is in excess of the net income (computed without such deduction) for that year, the amount of the excess may be carried over and allowed as a deduction in computing the net income for the next succeeding taxable year (referred to in article 1623 as the "third year"). It should be noticed, however, that a "net loss"

for a preceding year may not be considered in computing a "net loss" for a succeeding year. (See section 206 (a).)

Treasury Regulations 75 promulgated under the Revenue Act of 1928 provide in part as follows:

APPLICATION OF REGULATIONS

(a) 1929 and Subsequent Years

These regulations are applicable only to the taxable year 1929 and to subsequent taxable years.

* * * * *

NET LOSSES

ART. 41. (c) *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.*

A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group.

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Supreme Court of the United States

OCTOBER TERM, 1931.

No. 582.

WOOLFORD REALTY COMPANY, INC.,
Petitioner,

against

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF OF AMICUS CURIAE, WITH MOTION FOR LEAVE TO FILE.

ROLLIN BROWNE,
Amicus Curiae,
22 Exchange Place,
New York, N. Y.

TAYLOR, BLANC, CAPRON & MARSH,
Of Counsel.

Supreme Court of the United States,

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WOOLFORD REALTY COMPANY, INC.,
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against
J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA,
Respondent.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

MAY IT PLEASE THE COURT:

The undersigned, as counsel for The Western Pacific Railroad Corporation and Utah Fuel Company, having secured the consent of counsel for the respective parties hereto, respectfully moves this Honorable Court for leave to file the accompanying brief in this case as *amicus curiae.*

ROLLIN BROWNE,
Amicus Curiae.

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BRIEF OF AMICUS CURIAE.

This brief, by the consent of the Court and with the consent of counsel for the respective parties, is filed by the undersigned as *amicus curiæ*, and on behalf of The Western Pacific Railroad Corporation and Utah Fuel Company, taxpayers whose income tax liability for the calendar years 1925 and 1926 depends upon the decision of questions involved in this case.

The Question.

This case presents the question of whether, under the Revenue Act of 1926, net losses sustained by a corporation in two years when it was not affiliated with any other corporation may be used as deductions in comput-

ing the consolidated net income of that corporation and another corporation in the succeeding year during which the two corporations were affiliated and for which a consolidated return was filed, when the corporation sustaining the net losses has, without consideration of such net losses, no separate net income of a positive quantity in such succeeding year.

The Facts.

The relevant facts are set out in the brief of counsel for petitioner, as well as in the opinion of the United States Circuit Court of Appeals for the Fifth Circuit (53 Fed. (2d) 821). They may be summarized as follows:

	1925	1926	1927
Piedmont Savings Co. ...	*(43,478.25)* (1)	*(410.82)* (1)	*453.80* (2)
Woolford Realty Co.	Not affiliated	Not affiliated	36,587.62 (3)
Consolidated net income, before any net loss deduction			36,133.82

(1) Statutory "net loss".
(2) Separate loss or minus net income.
(3) Separate net income.

POINTS OF ARGUMENT.

Point I. The net loss for 1925 should be allowed in full.

Point II. The effect of Respondent's position on cases where the corporations were affiliated for all three years.

POINT I.

The net loss for 1925 should be allowed in full.

Broadly speaking, the problem presented is that of harmonizing the "consolidated returns" provisions of Section 240 with the "net loss" provisions of Section 206 of the Act. The net loss deduction, like all other deductions allowed in the Act, is allowed to "corporations" or to "taxpayers". An affiliated group of corporations filing a consolidated return is neither a corporation nor a taxpayer, because even where the tax is computed on a consolidated return, it is assessed against the individual corporations comprising the group, according to a prescribed method of allocation.

Swift & Company v. *United States*, 69 Ct. Cls. 171, 38 Fed. (2d) 365.
Sweets Company v. *Commissioner*, 40 Fed. (2d) 436.

No provision of the statute states what shall constitute income of, or what shall be allowed as deductions to, an affiliated group. Section 240 (a) and (b) merely permit affiliated corporations to make a consolidated return of net income and provide that, in such cases, the tax shall be computed and determined as a unit upon the basis of the consolidated return.

Obviously all items of income and deductions of all the corporations comprising the group must be taken into account. (The elimination of inter-company items is no real exception, because, on principles of sound accounting and common sense, that which is one member's gain on an inter-company transaction is the other member's loss.) If the deductions of one member exceed its income items, the excess goes to reduce the taxable income of the other members, or the consolidated net in-

come of the group. Section 234 (a) provides that "in computing the net income of a corporation subject to the tax" (i. e., of a "taxpayer") these deductions shall be allowed. No provision in terms requires or permits that they shall be allowed in computing the net income of an affiliated group or the net income of any other taxpayer (and every other member of the group is a separate, distinct "taxpayer"), yet the deductions are so allowed, and must be, in order to give effect to the "consolidated returns" provisions of Section 240.

The Treasury Department concedes the correctness of the foregoing with respect to all deductions allowed by the Act to each member of the group, with the sole exception of the "net loss" deduction allowed in Section 206. And yet the Act draws no distinction, as to rank, degree or extent, between the so-called ordinary deductions allowed in Section 234 and the "net loss" deduction. Section 232 defines net income of a corporation as "gross income as defined in Section 233, *less the deductions allowed by Sections 234 and 206.*" This would seem to dispose of the question if "words mean what they say, and not the opposite," as the court below insisted on excellent authority, but the Treasury Department contends for, and the court below sustained, a distorted, strained interpretation of the Act on the claimed ground that otherwise an unjust result would be reached which the Congress could not have intended. When considering the Treasury Department's request thus to rewrite a statute to conform with its, or even the Court's, ideas of how the statute should have been written, this Court will not overlook the salutary rule announced by Mr. Justice Cardozo, writing as Chief Judge of the New York Court of Appeals, in *People ex rel. Studebaker Corporation* v. *Gilchrist,* 244 N. Y. 114, at pages 125 and 126, that:

> "The taxing officers of the State are mere administrative agents. They may not devise new

> forms and methods of taxation, however convenient or useful. * * * If one method of assessment or collection is pointed out, the courts will not permit the application of another on the theory that the Legislature might just as well have chosen it, * * *."

As this Court said in *United States* v. *Goldenberg*, 168 U. S. 95, 102:

> "The primary and general rule of statutory construction is that the intent of the lawmaker is to be found in the language that he has used. He is presumed to know the meaning of words and the rules of grammar. The courts have no function of legislation, and simply seek to ascertain the will of the legislator."

The Treasury Department first objects that if a net loss of one corporation should be allowed as a deduction in computing consolidated net income of an affiliated group, in excess of the net income (computed without regard to such net loss) of the particular corporation sustaining the net loss, the benefit of the deduction, to the extent of the excess, would be given to other "taxpayers", whereas the Act gives the benefit only to *the taxpayer*. But it must be apparent that this objection applies with equal force to the deductions allowed by Section 234, which, also, are allowable only in computing the net income of *the taxpayer*, and yet the excess of the interest and taxes (for instance) paid by one member over its gross income is concededly allowable to reduce the taxable income of the group or the other members thereof. This was the deliberate intention of the Congress in providing for consolidated returns, i. e., to tax "as a business unit what in reality is a business unit" (Cong. Record, Vol. 57, Part I, p. 255).

The Act itself recognizes that, unless specifically limited, every deduction, credit and exemption allowed to

each member of the group must be taken into account in computing the tax on a consolidated return. Section 236 (b) allows every corporation, whose net income is $25,000. or less, a credit of $2,000., and since it was not desired that each member of an affiliated group have such a credit, Section 240 (b) expressly provides that only one such credit shall be allowed on a consolidated return.

The Treasury Department next objects that since the net loss deduction is allowable only in computing "net income" (which, it is contended, means net income of the particular taxpayer corporation) and since "net income" always must be a positive figure, the net loss deduction cannot be allowed to an amount greater than sufficient to reduce the particular corporation's net income to zero.

In the first place, we point out that this objection, also, applies equally to the ordinary deductions since they, too, are allowable only "in computing net income" and yet we have seen that so to limit the allowance of the ordinary deductions would nullify to a large extent the result intended to flow from consolidated returns, and we also know that the Department has never attempted so to limit them.

Secondly, and for the same reason, we submit that, under the general scheme of the law, the "net income", in the computation of which a deduction is allowed *on a consolidated return,* must mean *consolidated net income.*

Thirdly, we urge that there is no justification for saying that "net income" must always be a positive figure. "Net income" as used in the Act is a term of art, defined in effect as "gross income" less certain deductions (which, as pointed out above, include the net loss deduction). The result in every case is "net income" whether it be plus or minus, black or red. The Treasury Department urges that it is inadmissible so to construe the term because, it is claimed, where the result is minus it is not "net income" but "net loss" and a net loss cannot

be used to produce or increase a net loss. But "net loss", also, is a term of art. It does not mean "gross income" less "deductions", in cases where, perchance, the result is minus, but it is defined in Section 206 (a) as the excess of the ordinary "deductions allowed by Section 234" (not including, be it noted, the net loss deduction allowed by Section 206) over gross income, "with the following exceptions and limitations" specifically set out.*

The former Secretary of the Treasury himself has recognized this obvious point, that "net income" may be either a positive or a negative quantity. In a statement published in the Internal Revenue News (Vol. 2, No. 8, p. 17—February 1929) in explaining the new Regulations under the Revenue Act of 1928, Mr. Mellon stated that:

> "The net income of the affiliated group is, in effect, the *algebraic* sum of the net incomes of the separate corporations in the group * * *." (Italics supplied.)

Mr. Mellon must have used the adjective, "algebraic", intentionally. Its well defined meaning shows that he considered that "net income" might be either a positive or a negative figure (Webster's International Dictionary, "algebraical"), and, as we have stated above, the Treasury Department concedes that consolidated net income is made up, in effect, of the algebraic addition of the positive and negative "net incomes" of the members of the group where any such negative net income results from an excess of the ordinary deductions allowed in Section 234 over the gross income. What the Department's contention really amounts to is that a negative net income cannot be produced or increased by a net loss deduction and yet the Act draws no distinction between the treat-

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*Section 117 (a) (6) of the Revenue Act of 1928 expressly provides that a prior year's net loss shall not be allowed as a deduction in computing a net loss, but this was necessary because the definition of net loss in the 1928 Act is "the excess of the deductions allowed *by this title* over the gross income, with the following exceptions and limitations:".

ment of net loss deductions and other deductions in computing "net income", although such a distinction is drawn in connection with the computation of a "net loss", in that the Act deliberately excludes "net losses" from the deductions allowable in computing "net losses".

Further confirmation of the soundness of the foregoing is found in Section 206 (b) of the Act. The net loss for the first year is allowed as a deduction in computing net income for the second year, but it is provided expressly that if such net loss is in excess of such net income "computed without such deduction", such excess shall be allowed as a deduction in computing net income for the third year. It is because of this express limitation that a net loss is not allowable in the second year, in excess of the second year's net income computed without the net loss deduction—otherwise the entire amount would be allowable in the second year. Since the full allowance of it in the second year in such cases would not benefit the taxpayer (because a net loss for one year cannot produce or increase a net loss for another year), Congress desired to preserve the benefit of such excess for the third year, and it was recognized that an express limitation was required in order to prevent the allowance of the full net loss in the second year, where it would yield no benefit, except possibly, but not necessarily, in cases of consolidated returns.*

Whether or not, in order to tax "as a business unit what in reality is a business unit" and in order fully to harmonize the consolidated returns provisions with the net loss provisions, this express limitation as to the sec-

* Strictly speaking, the law does not thus limit the net loss deduction as to the second year. The full amount of the loss is allowable "in computing net income" of the second year, *and* (also) the excess of the net loss over the second year's net income is allowed again as a deduction in computing the third year's net income. Since the net loss is allowed merely in computing the second year's *net income*, and is not allowable in computing a *net loss* for the second year, such double deduction is not unfair. Although, technically, the net loss deduction thus may be allowed twice (in part), the taxpayer benefits from it but once, partly in one year and partly in another.

ond year should be construed, in cases of consolidated returns, as applying only where the net losses of all member corporations exceed the consolidated net income for the second year, *rather than where the net loss of each member exceeds the net income of that member for the second year*, is of no importance here, since, regardless of the correct answer to that question, the net loss for 1925 (the first year) is clearly allowable in full in computing net income for 1927 (the third year) which is the year in issue, because the Act imposes no such limitation with respect to the third year, but as to the third year the net loss is allowable in full, in the same manner and to the same extent as any other deduction. That question does, however, affect the right to deduct the net loss for 1926 (again the first year) in computing the net income for 1927 (in this instance, the second year), to the extent necessary to reduce 1927 consolidated net income to zero, but in this case the allowance of the 1925 net loss alone will have reduced the 1927 consolidated net income to below zero.

POINT II.

The effect of Respondent's position on cases where the corporations were affiliated for all three years.

One further consideration of utmost importance remains to be discussed. The position of the Treasury Department in this case is not based on the fact that the net losses were sustained in years during which the Piedmont Savings Company was not affiliated with Petitioner, although the court below apparently considered that the most important feature of the case and based its decision principally on the ground that

> "a ruling which permits a corporation, with a consistent record of gains, to affiliate with one having

> a large accumulation of statutory net losses for the purpose and with the result of using these losses in the year of affiliation * * * appears generally inappropriate to the federal scheme of income taxation * * *."

The Treasury Department's views as to this phase of the case are significant. The Department first conceded that a net loss prior to affiliation may be deducted on a consolidated return for a later year, and although this deduction was limited, as to the second year, to the amount of the net income of the particular corporation which sustained the net loss, no such limitation was applied as to the third year. (Solicitor's Law Opinion 1113, Par. 4, III-2 Internal Revenue Cumulative Bulletin 36, p. 41). In General Counsel's Memorandum 3266, VII-1 C. B. 205, the Department extended this limitation (to the amount of the net income of the particular corporation which sustained the net loss) to the third year, under the Revenue Act of 1921, in which net income was defined as constituting gross income less only the ordinary deductions allowed by Section 234.

Subsequently, the Department, following the erroneous opinion of the Board of Tax Appeals in *The Sweets Company of America* v. *Commissioner,* 12 B. T. A. 1285, took the position that where a consolidated return is filed the consolidated group itself is the "taxpayer" and that where the composition of the group changes between the year in which the net loss was sustained and the year in which its benefit is claimed, the deduction cannot be allowed because the Act allows the deduction only to the "taxpayer" which sustained the net loss. (This view was expressed in the Government's briefs filed in a number of cases and in its unpublished rulings issued in a great many specific cases.)

After the erroneous views of the Board of Tax Appeals were disapproved on appeal by the Second Circuit

Court of Appeals (40 Fed. (2d) 436) and by the Court of Claims in *Swift & Company* v. *U. S., supra,* the Department again conceded, and still concedes, that a net loss prior to affiliation may be deducted on a consolidated return for a later year, but the Department now limits this deduction, not only as to the second year but also as to the third year, to the amount of the net income of the particular corporation which sustained the net loss, even under the Revenue Acts of 1924 and 1926, both of which define net income as gross income *less the ordinary deductions and the net loss deduction.* (General Counsel's Memorandum 8618, IX-2 C. B. 180.) We have shown that there is no justification for such a limitation on the allowance of the net loss deduction, particularly as to the third year.*

The Department would apply this limitation to cases where the affiliated group had existed unchanged throughout all three years (General Counsel's Memorandum 8132, IX-1 C. B. 287), and the court below probably would sustain it (*Planters' Cotton Oil Co.* v. *Hopkins,* 53 Fed. (2d) 825). It is in cases of that class that the Department's theory reaches the most preposterous result and works the greatest injustice. An excellent example of how the Department's theory affects such cases may be found in the following hypothetical case which, except for immaterial variations, is on all fours with the actual situation of the Utah Fuel Company, on behalf of which this brief is filed.

Company A owns in its own right and operates certain coal mines. Since the inception of the income tax laws Company A has owned the entire capital stock of

* Article 41 (c) of Regulations 75, applicable to 1929 and later years, which have the force of law under the Revenue Act of 1928, expressly recognizes the right to deduct a net loss prior to affiliation, without limiting the deduction, as to either the second or third year, to the amount of the particular corporation's net income during affiliation, although an entirely new limitation (based on the amount paid for the stock of the corporation which sustained the net loss) is imported for the first time, but only as to 1929 and later years, and this new limitation was designed expressly to cure the above quoted objection of the court below.

Company B, which owns and operates other coal mines in the same area. These companies have always filed consolidated returns. Their business, consisting of the mining and selling of coal, has always been conducted as one unit—in fact, the operations of Company B have been conducted as a mere branch or department of the business. In 1924 an explosion occurred in one of the mines belonging to Company B, as a result of which Company B sustained a net loss for that year, computed separately, of $1,000,000. Company A had a net income for that year, computed separately, of $400,000. The consolidated return, therefore, showed a consolidated net loss of $600,000., all of which was attributable and allocable to Company B, under the regulations of the Commissioner of Internal Revenue. Therefore, Company B (a taxpayer) sustained a net loss for 1924 of $600,000.

For 1925 and also for 1926 Company B had a loss or a minus net income, computed separately, of $100,000., due also to the 1924 explosion. For each of those years, Company A had a net income, computed separately, of $600,000. The consolidated net income for each of those years (without taking any net loss into consideration) was, therefore, $500,000.

In such a case, the Commissioner would refuse to allow any part of Company B's 1924 net loss as a deduction in computing consolidated net income of the group for either 1925 or 1926, (although Regulations 75 expressly require the allowance as to 1929 and later years), and he would base his decision upon the same grounds relied upon by Respondent in this case, i. e., that the benefit of the net loss is allowable only to the taxpayer which sustained it and not to any other member of the affiliated group; that a net loss is allowable only in computing net income; that net income must always be a positive, and can never be a negative, quantity; that Company B had no net income of a positive

quantity for either 1925 or 1926; and that for these reasons no part of the 1924 net loss would be allowable in either 1925 or 1926.

It is respectfully submitted that an application of the Act which produces such a harsh result subordinates the "consolidated returns" provisions, even sacrifices them, to a strained interpretation of the "net loss" provisions, rather than harmonizing these two component parts of a single taxing statute in a manner which gives full effect to the spirit and intent of both parts without doing violence to the literal language of either. It certainly nullifies the scheme of "taxing as a business unit what in reality is a business unit" which was the *raison d'etre* of the consolidated returns provisions.

Respectfully submitted,

ROLLIN BROWNE,
Amicus Curiae.

TAYLOR, BLANC, CAPRON & MARSH,
Of Counsel.

Dated: New York, March 14, 1932.

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WOOLFORD REALTY COMPANY, INC., PETITIONER,

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE AND BRIEF OF AMICI CURIAE.

ALFRED S. WEILL,
HUGH SATTERLEE,
ALBERT S. LISENBY,
Amici Curiae,
1016 Munsey Building,
Washington, D. C.

WEILL, SATTERLEE, SPENCE & BLAKELY,
Of Counsel

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE.

May it please the Court:

The undersigned respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae*.

ALFRED S. WEILL,
HUGH SATTERLEE,
ALBERT S. LISENBY,
Amici Curiae.

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BRIEF OF ALFRED S. WEILL, HUGH SATTERLEE AND ALBERT S. LISENBY AS AMICI CURIAE.

STATEMENT.

This case was decided by the District Court for the Northern District of Georgia upon a general demurrer to the petition. The judgment was affirmed by the Circuit Court of Appeals for the Fifth Circuit. This Court granted a writ of certiorari on January 25, 1932.

The petitioner and the Piedmont Savings Company were affiliated corporations during the year 1927, but were not so affiliated for 1925 and 1926. The two corporations filed separate returns of income for 1925 and 1926, but for the year 1927 filed a consolidated return, which was accepted by the Commissioner of Internal Revenue.

The gross income of the petitioner for 1927, within the meaning of Section 233 of the Revenue Act of 1926, exceeded its deductible expenses and losses, allowed under Section 234, by the amount of $36,587.62, thus leaving the petitioner, without consolidation, with a plus balance of income of

$36,587.62. The deductible items of the Piedmont Savings Company for 1927, allowed under Section 234, exceeded its items of gross income, within the meaning of Section 233, by $453.80, thus leaving it, without consolidation, with an income balance of minus $453.80. In determining the consolidated taxable net income of the two corporations for 1927, the Commissioner offset the minus $453.80 of the Piedmont Savings Company against the plus $36,587.62 of the petitioner, and arrived at a consolidated net income of the two corporations in the amount of $36,133.82, on which the tax was assessed and paid.

The effect of the Commissioner's action, therefore, was to apply net deductions of Piedmont Savings Company allowed under Section 234 of the Revenue Act of 1926, amounting to $453.80, against gross income of the petitioner, since all the deductions of Piedmont Savings Company in excess of $453.80 had already been absorbed in offsetting the full gross income of Piedmont Savings Company.

However, Piedmont Savings Company had also sustained statutory net losses for 1925 and 1926, within the meaning of Section 206 of the 1926 Act, in the respective amounts of $43,478.25 and $410.82. These deductions allowed by the statute the Commissioner refused to take into account in computing the taxable net income on the consolidated return for 1927.

ISSUE.

The issue in this case is whether, in determining the net income for the taxable year 1927 of the affiliated group, consisting of the petitioner and Piedmont Savings Company, deductions for the net losses of Piedmont Savings Company during 1925 and 1926 should be taken into account.

The broad question necessarily involved, however, is whether the net income of a group of affiliated corporations filing a single consolidated income tax return shall be computed as that of a single business enterprise, or whether, notwithstanding affiliation and the filing of a single consolidated return as provided for and permitted by law, the consolidated status

shall be ignored and the affiliated corporations treated as entirely separate enterprises in computing the tax liability under Section 240 of the Revenue Act of 1926.

STATUTES.

The statutory provisions immediately in point are found in the Revenue Act of 1926, as follows:

"Sec. 230. (a) In lieu of the tax imposed by section 230 of the Revenue Act of 1924, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation, a tax at the following rates:* * * ."

"Sec. 232. In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, * * *."

"Sec. 233. (a) In the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217, * * *."

(Sec. 213 defines gross income generally as gains, profits and income derived from any source whatever, and Sec. 217 defines the net income of nonresident alien individuals.)

"Sec. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions: * * *"

(The deductions allowed are listed, being, in general, the expenses and current losses of the business.)

"Sec. 206. (a) As used in this section the term 'net loss' means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations: * * *

(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year'), and if such net loss is in excess of such net income (com-

puted without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary." * * *

"Sec. 239. (a) Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title." * * *

"Sec. 240. (a) Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236. * * *"

SUMMARY OF ARGUMENT.

The statutory net losses of the Piedmont Savings Company for 1925 and 1926 are allowable deductions on the return of consolidated net income of the petitioner and Piedmont Savings Company for 1927, because:

I. The purpose of a consolidated return, as shown by the legislative, administrative and judicial history of the provisions of the statutes involved, is to treat the gross income and deductions of an enterprise carried on through the instrumentality

of separate but affiliated corporations as those of a single tax computing unit.

II. The consolidated net income of the petitioner and its affiliated company is required to be computed on a consolidated basis, giving effect to the items of gross income and deductions of both members of the group, including the statutory net losses of Piedmont Savings Company. The plain and unambiguous language of the statute places the statutory net losses in the same category as any of the other statutory deductions, and there is no warrant for departing from the statute. To do so would be to levy the tax under no provision of law and create doubt as to its constitutionality. The allowance o the deduction accords with the statute, the fundamental conception of a consolidated return, the decisions of the Board of Tax Appeals and the Circuit Courts of Appeal for the Third and Fourth Circuits, and involves no illogical consequences.

III. The regulations of the Treasury Department in administrative interpretation of substantially similar provisions of law now recognize and allow the deduction claimed.

ARGUMENT.

I.

The history of the statutory provisions for consolidated returns of corporations, the rulings of the Bureau of Internal Revenue in administration of such provisions, and the decisions of the Board of Tax Appeals and the courts with respect thereto, show that the purpose of a consolidated return for affiliated corporations in lieu of separate returns is to treat the income and deductions of an enterprise carried on through the instrumentality of separate corporations as those of a single tax computing unit.

A correct determination of the issue presented requires a consideration of the history of the consolidated returns provisions and the construction placed upon them in practical application by the Bureau of Internal Revenue, the Board of Tax Appeals and the courts.

Prior to the passage of the Revenue Act of 1918 there existed no specific statutory authority for the filing of consolidated returns by affiliated corporations. However, in the exercise of his general authority to promulgate regulations, with the approval of the Secretary of the Treasury, the Commissioner of Internal Revenue promulgated Articles 77 and 78 of Regulations 41, defining affiliation and requiring the filing of a consolidated return for excess profits taxes under the Revenue Act of 1917. The regulations were later validated retroactively by section 1331 of the Revenue Act of 1921.

The Bureau of Internal Revenue and the Congress were persuaded by the results of the Commissioner's administration of the regulations under the 1917 Act that a consolidated return instead of separate returns for affiliated corporations would prevent the arbitrary shifting of income between components of the group and, as well, more properly reflect in law the true income of what was a business unity in fact, thus preventing evasion of taxes, on the one hand, and excessive and arbitrary taxes, on the other. Accordingly, a provision, section 240, was incorporated in the Revenue Act of 1918 specifically providing for a consolidated return in the case of an affiliated group of corporations. In reporting the proposed act to the Senate, the Committee on Finance had this to say in respect of the matter:

> "Provision has been made in section 240 for a consolidated return, in the case of affiliated corporations, for purposes both of income and profits taxes. A year's trial of the consolidated return under the existing law demonstrated the advisability of conferring upon the Commissioner explicit authority to require such returns.
>
> So far as its immediate effect is concerned a consolidation increases the tax in some cases and reduces it in other cases, but its general and permanent effect is to prevent evasions which can not be blocked in any other way. * * * [After discussing methods of evasion.] While the committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its

effect upon the revenue, but because the principle of taxing as a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government."

(See Senate Report 617, to accompany H. R. 12863, December 6, 1918, Sixty-fifth Congress, 3d session, pages 8 and 9.)

The provision referred to survived the conference and became section 240 of the Act. (Senate Document 385, Sixty-fifth Congress, 3d session, page 27, section 240; House Report 1037, conference report, page 15; 57 Cong. Rec. 255. *Appeal of Farmers Deposit National Bank*, 5 B. T. A. 520, 525; *United States* v. *Cleveland Painesville & Eastern Railroad Co., Inc.*, 42 Fed. (2d) 413.)

Pursuant to the act the Commissioner of Internal Revenue promulgated greatly amplified regulations respecting the filing of consolidated returns and the determination of the consolidated net income of affiliated corporations. (Articles 631–638, Regulations 45 (1920 edition).) Article 631 of the regulations provided:

"The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of *a single business enterprise, even though the business is operated through more than one corporation.*" (Italics ours.)

With immaterial changes, the subsequent revenue acts have reenacted the consolidated returns provisions as they were found in the 1918 Act, and the Commissioner has in subsequent regulations under those later acts continued to interpret the purpose of the provisions in the same way as he did under the 1918 Act. (Section 240, Revenue Acts of 1921, 1924, and 1926, and section 141, Revenue Act of 1928; Article 631, Regulations 62, 65 and 69, and Article 31, Regulations 75.)

The rulings of the Bureau of Internal Revenue have consistently adhered to the fundamental conception that the income of a group of several affiliated corporations is really

that of a single enterprise.[1] The same view has been taken by this Court, which, in *Handy & Harman* v. *Burnet*, 284 U. S. 136, 140, said:

> "The purpose of § 240 was, by means of consolidated returns, to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise, even though it was conducted by means of more than one corporation."

The Circuit Courts have also, in varying language, accepted the view that the real basis for the consolidated return is the principle of levying the tax according to the true net income of a single enterprise, even though the business is operated through more than one corporation.[2]

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[1] O. D. 415, Cumulative Bulletin 2, p. 226.
A. R. R. 448, " " 4, pp. 314, 315
A. R. R. 624, " " 5, pp. 234, 235
I. T. 1386, " " I–2, p. 32.
I. T. 1600, " " II-1, pp. 184, 185
A. R. R. 2958 " " II-2, pp. 214, 215.
S. M. 1530, " " III–1, pp. 307, 308.
L. O. 1113, " " III–2, pp. 36, 39.
S. M. 2683, " " IV–1, pp. 238, 239.
S. M. 2396, " " IV–1, pp. 240, 241.
S. M. 3384, " " IV–1, pp. 277, 279.
I. T. 2261, " " V–1, pp. 100, 101.
I. T. 2355, " " VI–1, p. 98.
G. C. M. 6640, " " VIII–2, p. 212.

[2] *Ice Service Co.* v. *Commissioner*, 30 Fed. (2d) 230, 231 (C. C. A. 2d).

Flannery & Co. v. *Commissioner*, 42 Fed. (2d) 11 (C. C. A. 3d).

Lavenstein Corporation v. *Commissioner*, 25 Fed. (2d) 375, 376 (C. C. A. 4th).

U. S. v. *Cleveland P. & E. R. R. Co.*, 42 Fed. (2d) 413 (C. C. A. 6th).

W. S. Bogle & Co. v. *Commissioner*, 26 Fed. (2d) 771, 772 (C. C. A. 7th).

Fidelity Nat. Bank & Trust Co. v. *Commissioner*, 39 Fed. (2d) 58, 61 (C. C. A. 8th).

Golden Cycle Corporation et al. v. *Commissioner*, 51 Fed. (2d) 927, 931 (C. C. A. 10th).

Able and illuminating discussions of the fundamental concept underlying the consolidated returns provisions, in thorough harmony with the foregoing views, are contained in the opinions of the Board of Tax Appeals in *Appeal of Gould Coupler Co.*, 5 B. T. A. 499, 513, and *Appeal of Farmers Deposit National Bank*, 5 B. T. A. 520, 525. We shall have occasion later in this brief to quote from these decisions.

In view of the legislative and administrative history of the consolidated returns provisions, there can be no doubt of the underlying purpose and meaning of a consolidated return, but the foregoing statements are confirmed by a recent expression of the Congressional understanding and intent with respect to such returns.

The original draft of the Revenue Act of 1928, as reported from the Committee on Ways and Means to the House, proposed to abolish consolidated returns after 1929. (Union Calendar No. 3, House Report No. 2, 70th Congress, 1st session, page 20, sec. 118.) In the House the provision was stricken out during consideration of the bill, but in the Senate the Committee on Finance inserted a substitute provision, and in its report to the Senate (Calendar No. 987, Senate Report No. 960, 70th Congress, 1st session, page 14) said:

> "The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. Unless the affiliated group as a whole in the conduct of its business enterprise shows net profits, the individuals conducting the business have realized no gain. The failure to recognize the entire business enterprise means drawing technical legal distinctions, as contrasted with the recognition of actual facts. The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every

one of its agencies. It would be just as unreasonable to demand that an individual engaged in two or more businesses treat each business separately for tax purposes."

II.

The consolidated taxable net income of the petitioner and its affiliated company for 1927 is required to be computed on a consolidated basis, giving effect to the items of gross income and deductions of both members of the group, including deductions for the statutory net losses of Piedmont Savings Company, and the court below erred in determining the taxable income of the affiliation as if the companies were filing separate returns.

The error of the court below is based on its misconception of the fundamental theory, purpose and meaning of a consolidated return. It reached an erroneous result because it assumed the premise that the consolidated net income is to be determined by computing the net income of each member of the affiliated group separately in disregard of their affiliated status and then summarizing the results. (Even so, it was not consistent in the application of its own theory.) If the court below was correct the consolidated returns provisions, of long legislative and administrative history, are of no real meaning and accomplish no purpose, because the several affiliated corporations filing a consolidated return would be left substantially as if they had filed separate returns.

It is pertinent to inquire as to precisely what is meant by the determination of net income on a consolidated basis.

The statutory provisions for consolidated returns of corporations, beginning with the Revenue Act of 1918 (section 240) and continuing through the Revenue Acts of 1921 (section 240), 1924 (section 240), 1926 (section 240), and 1928 (sections 141 and 142), have not in terms provided for the method of computation of consolidated net income. The earlier Acts provided, as in the case of the Revenue Act of 1926, that affiliated corporations should or might make a consolidated return of net income, and in such event that the total tax should be computed in the first instance as a unit. The Revenue Act of 1928,

section 141, applying to 1929 and subsequent years, provided merely that an affiliated group of corporations might make a consolidated return, pursuant to regulations prescribing that the tax liability be computed in such manner as clearly to reflect the income, and in such event that the tax should be computed in accordance with such regulations.

From the beginning, therefore, it was necessary for the Treasury Department to promulgate regulations for the determination of consolidated net income. Under the earlier Acts, including the Revenue Act of 1926, the regulations pertaining to consolidated net income were practically identical, and under Section 141 of the Revenue Act of 1928 the corresponding regulation, while more explicit, is to like effect. For convenience the pertinent articles of the regulations under the earlier Acts and under the Revenue Act of 1928, respectively, are here set forth in parallel columns.

Article 635 of Regulations 69, relating to the 1926 Act (to which Article 636 of Regulations 65, Article 636 of Regulations 62, and Article 637 of Regulations 45, relating respectively to the 1924, 1921 and 1918 Acts, are similar), provides in part:

"ART. 635. *Consolidated net income of affiliated corporations.*

Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. * * *

Article 31 of Regulations 75, relating to the 1928 Act, provides:

"ART. 31. *Consolidated Net Income.*

(*a*) *Definition.*

Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as 'intercompany transactions').

In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited."

(*b*) *Statements and Schedules for Subsidiaries.*

The statement of gross income and deductions and the several schedules required by the instructions on the return must be prepared and filed by the parent corporation in columnar form so that the details of the items of gross income and deductions for each member of the consolidated group may be readily audited. Such statements and schedules shall include in columnar form a reconciliation of surplus for each such corporation, together with a reconciliation of the consolidated surplus. Consolidated balance sheets as of the beginning and close of the taxable year of the group, taken from the books of the group, shall accompany the consolidated return prepared in a form similar to that required for reconciliation of surplus."

The provisions of the present regulations mark no departure from the meaning of previous regulations, for whether the consolidated income be said to be "the combined net income of the several corporations consolidated" or "the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members," the substance is the same. The several components are merged into one and their separate identities ignored for purpose of computing the "consolidated" income.

Because it throws so much light on the point, we quote at length from the opinion of the Board of Tax Appeals in *Appeal of Gould Coupler Co.*, 5 B. T. A. 499, 513, construing the like provisions of the Revenue Act of 1918:

"This leads to a consideration of what Congress intended when it said in section 240 (a) 'corporations which are affiliated * * * shall * * * make a consolidated return of net income and invested capital for the purposes of this title (income tax) and Title III (profits taxes), and the taxes thereunder shall be computed and determined on the basis of such return,' and, later, 'the total tax shall be computed in the first instance as a unit.' There are two other questions in this case, to be referred to presently, the answers to which also depend upon the construction of this language. Much controversy has arisen over what was meant by the term 'consolidated return,' and there are current two conflicting points of view. One, commonly referred to as the 'legal theory,' maintains that 'consolidation' is a matter of procedure, and the consolidated invested capital and net income should be the sum of the amounts of invested capital and net income, separately computed for each of the several affiliated corporations. Under the other, known as the 'accountant's' or 'economic unit' theory, all inter-company transactions and relationships are eliminated, and a resulting balance sheet and profit and loss statement is obtained which shows the situation as though it were a single business. The advocate of either theory generally insists that his theory should be adhered to consistently in applying section 240."

After reviewing the legislative history of the consolidated returns provisions, the Board proceeded (at p. 515):

"It is plain that the purpose was to circumvent intercompany dealing and accounting practices, of whatever origin or object, through which the invested capital or net income of a corporation in a group under common control might be artificially increased or diminished, with the attendant effect on the taxes upon such company if separately assessed. The so-called 'legal' theory does not fulfill this purpose, nor does the language of the statute support this theory. Section 240 provides that the taxes shall be computed as a unit—not as an aggregate—and upon the basis of a consolidated return. The verb 'to consolidate' means more than to add together; it means to weld into one things that previously were separate. It is derived from the Latin verb *consolidare*, 'to make firm or solid.'

The following definitions are given in Murray's New English Dictionary: 'To make solid, to form into a solid or compact mass; to solidify; to combine compactly into one mass, body or connected whole (territories, estates, companies, administrations, commercial concerns and the like).' The participial adjective 'consolidated' is defined to mean 'made solid, firm or compact; solidified; combined, unified.' The language of section 240 and its legislative background show that Congress used the word 'consolidated' in the sense of 'unified'; there is nothing to indicate they used it in the sense of 'summarized.' Further, it appears from the report of the Finance Commitee that section 240 was recommended after a year's trial of the consolidated return under the 1917 law. This is the time during which Regulations 41, Articles 77 and 78, quoted above, were in force. These articles, it will be noted, provide that the Commissioner may cause an examination of the books of all of the affiliated corporations to be made and a 'consolidated statement' to be made there from. The word 'consolidated' had become current in accounting nomenclature to describe balance sheets, profit and loss statements, and income statements of a group of companies connected with each other by control of stockholdings. Such statements are used in business to show the financial condition or earning power of an undertaking thus constituted after eliminating all the relations of the constituent companies one to another. The consolidated balance sheet represents the ultimate financial position of the group to the outside world after the elimination of the inter-company relationships.

In the light of the genesis of section 240, the object sought to be attained, and the sense in which the word 'consolidated' is used in accounting practice, we are led to the conclusion that Congress intended to require consolidated returns of net income and invested capital arrived at by constructing a single composite invested capital for the group from which duplications and inter-company obligations would have been eliminated, and one statement of net income based on a profit and loss statement from which would have been eliminated all intercompany losses, profits, and other transactions affecting income."

In *Appeal of Farmers Deposit National Bank*, 5 B. T. A. 520, the Board of Tax Appeals was also interpreting section 240

of the 1918 Act, the statutory forerunner of the provisions here involved. It said (p. 523 *et seq.*):

> "Here in the provisions of section 240 (a) we have the key to the whole situation. Underlying these provisions of the statute is a purpose which must be ascertained, and the statute must be construed in such a manner as to make that purpose effective. While the return required by the provisions of section 240 (a) is 'a consolidated return of net income and invested capital,' it is entirely clear from other provisions of the same section that the return contemplated is a return of 'consolidated net income and invested capital.' For instance, Congress has specified that the net income and invested capital of certain affiliated corporations shall be taken out of 'such consolidated net income and invested capital,' and that the remainder of the affiliated group shall be assessed on the basis of the remaining 'consolidated invested capital and net income.'
>
> * * * 'Consolidated net income' means the gross income of the affiliated group, as defined in section 233, less the deductions allowed to the affiliated group by section 234.
>
> Then, by the provisions of the second paragraph of section 240 (a), we find that, in any case in which a taxpayer is assessed upon the basis of a consolidated return, the total tax is to be computed in the first instance as a unit and then assessed upon the respective affiliated companies in such proportions as may be agreed upon among them. That is, the total tax liability of the affiliated group is to be computed and determined upon the basis of the consolidated net income and invested capital, as shown in the return, in the same manner as though the return was that of a single corporate taxpayer filed in accordance with the provisions of section 239. Further than this, the specific credit and exemptions allowed to an affiliated group, for the purpose of computing the income, war-profits, and excess-profits taxes, respectively, are the same specific credit and exemptions allowed to a single corporate taxpayer by the provisions of sections 236, 311, and 312, respectively.
>
> Thus we find from the provisions of section 240 (a) that in any case where two or more corporations are affiliated, within the meaning of the provisions of sub-

division (b) of the same section, a single return setting forth the items of gross income and the deductions of the affiliated group satisfies the requirements of section 239 that every corporation subject to taxation shall make a return; that the tax liability of the affiliated corporations is to be determined upon the basis of the consolidated net income and invested capital, in the same manner as though the tax liability of a single taxpayer was being determined; and that in computing the tax liability of the affiliated corporations as a unit only such specific credit and exemptions are to be allowed as are allowed to a single taxpayer by the provisions of sections 236, 311, and 312. That is, for the purpose of determining the tax liability of the members of an affiliated group, the group is to be regarded and treated as a single corporate taxpayer."

It accordingly appears that the Commissioner of Internal Revenue, in his regulations quoted above at page 13, and the Board of Tax Appeals are in agreement as to the proper method of determining the consolidated net income of an affiliated group, namely, by subtracting from the aggregate of the items of gross income of the group the aggregate of the deductions of the group.

On the principles thus stated there can be no question that the statutory net losses of Piedmont Savings Company for 1925 and 1926 should be included as part of the aggregate of the deductions of the members of the affiliated group from the aggregate of the items of gross income of the members.

Referring specifically to the Revenue Act of 1926, in force during the taxable years, although the provisions of the other Acts are generally similar, Section 239 provides that every corporation shall make a return stating specifically the items of its gross income and the deductions and credits. Section 240 provides that, where affiliated corporations make a consolidated return of net income, the taxes shall be computed and determined upon the basis of such return. Section 232 provides that the term "net income" means gross income less "the deductions allowed by Sections 234 and 206." Section 234 provides for the deduction of business expenses, interest,

taxes, depreciation, etc., and Section 206 provides for the deduction of net losses of the last preceding year or two years. It must be borne in mind that the tax is laid on "net income," a purely statutory concept determined as above provided.

Giving effect to all these statutory provisions, in the light of the principles enunciated in the regulations and by the Board of Tax Appeals, the petitioner computed consolidated net income by subtracting from the aggregate gross income of the affiliated corporations the deductions allowed both under Section 234 and under Section 206, resulting in no taxable net income. On the other hand, the Circuit Court of Appeals, in derogation of the provisions of the statutes, arbitrarily computed consolidated net income by subtracting from gross income only the deductions allowed by Section 234, without taking into account the net losses for 1925 and 1926 allowed as deductions by Section 206,—even by this anomalous process arriving at minus net income in the case of Piedmont Savings Company and at a consolidated net income less than the separate net income of the petitioner.

The following table shows the contrasting computations by the petitioner and by the Circuit Court of Appeals, the figures for net income and net losses being taken from the record and the other figures being assumed for purposes of illustration:

	Woolford Realty Co.	*Piedmont Savings Co.*	*Consolidated or Combined*
A. Computation by petitioner.			
Gross income (Sec. 233)	$136,587.62	$10,000.00	$146,587.62
Deductions			
(Sec. 234)	100,000.00	10,453.80	110,453.80
(Sec. 206)	—	43,889.07	43,889.07
	$100,000.00	$54,342.87	$154,342.87
Net income or *loss* (Sec. 232)	36,587.62	*44,342.87*	*7,755.25*
B. Computation by Circuit Court of Appeals.			
Gross income (Sec. 233)	$136,587.62	$10,000.00	$146,587.62
Deductions (Sec. 234)	100,000.00	10,453.80	110,453.80
Net income or *loss* (Sec. 232)	36,587.62	*453.80*	36,133.82

The language of section 232 is too plain for dispute as to its meaning. It says:

> "In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, * * *."

It is not disputed that the Piedmont Savings Company had statutory net losses within the meaning of section 206 for 1925 and 1926, in the respective amounts of $43,478.25 and $410.82. Section 206 (b) and (c) provide that these "shall be allowed as a deduction in computing the net income." This language is the same in substance as that used in section 234 (a) with respect to any other kind of deductions, such as ordinary and necessary business expenses, interest, taxes, losses, depreciation and the like, which "in computing the net income of a corporation" it is provided by the section "shall be allowed as deductions." The deductions allowed "in computing the net

income" of a corporation by both section 206 and section 234 are equally applicable and to be used. There is clearly no warrant in law for disallowing the deductions on a consolidated return of either those provided in section 206 or those provided in section 234. They are by the Act itself placed in the same category, and the plain, unambiguous meaning of the Act must be ignored if one or the other are not to be allowed as deductions on the consolidated return.

The method used by the petitioner is in accordance with past and present regulations of the Bureau of Internal Revenue and with various published rulings of the Bureau of Internal Revenue,[1] and certainly is the method which must follow as

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[1]Office Decision 415, Cumulative Bulletin No. 2 (1920), p. 226, held: "The income of affiliated corporations which is derived from Government contracts is taxable (except as provided in sec. 240 (a) of the Revenue Act of 1918) upon the basis of the total sum received from that source by the group, and not upon the basis of the separate amount received by each corporation."

Solicitor's Memorandum 2683, Cumulative Bulletin IV–1, (1925), pp. 238, 239, contains this language: "The language of section 240 (a) is specific. It states that 'corporations which are affiliated * * * may make separate returns or, * * * make *a* consolidated return.' This language can mean but one thing; that the group as a whole may render individual corporate returns or that the group as a whole may render *a* consolidated return."

Solicitor's Memorandum 2396, Cumulative Bulletin IV–1 (1925), pp. 240, 241, distinguishes between the mere consolidation of accounts of non-affiliated corporations for purposes of making accurate distribution or apportionment of gains, profits, income, etc., as provided in section 240 (d) of the 1921 Act, a provision found in the other Acts also, and the case of a consolidated return, saying: "The consolidation of accounts in certain cases is 'for the purpose of making accurate distribution or apportionment' of gains, profits, income, etc. But if the returns were to be consolidated there would be no occasion for making any such distribution or apportionment."

As further illustrating the effect of a consolidation and the method to be used in computing the income in such cases, Income Tax Ruling 2261, Cumulative Bulletin V–1 (1926) pp. 100, 101, states: "It is the opinion of this office that the net

inevitable from the fundamental conception of the consolidated returns provisions. It simply assimilates all the items of gross income and deductions of the several members of the affiliated group into a common, combined, consolidated unit, and reaches the net result of the entire enterprise. The method disregards the accident of different branches of the same enterprise being in legally separate corporations, and, therefore, disregards as immaterial the question of which member of the group gave rise to a deduction, or against which member's gross income such deduction is to be applied. The computation involves solely the application of *all* deductions of the group against *all* gross income of the group.

This follows the theory outlined in Law Opinion 1113 of the Bureau of Internal Revenue, Cumulative Bulletin III–2, (1924), 36, 39, in which, with respect to a "net loss" of a member of an affiliated group filing a consolidated return under the 1918 Act, it was held:

> "Section 204 defines a net loss as the excess of the deductions allowed by law, with certain exceptions not here material, over the sum of the gross income plus any tax-exempt interest. Section 240 of the Act and the regulations issued thereunder provide that in the case of an affiliated group the net income on the basis of which the tax is computed and assessed shall be the net income of the group considered as a unit, such net income to be computed by deducting from the consolidated gross income the sum of all deductions to which the members of the group are entitled. *In other words, the net income of the group upon the basis of which the tax is computed and assessed is the amount of the gross income of the group, less all allowable deductions,* and an operating loss of a single member of a group is merely one of the allowable

---

income resulting from such a consolidation of the accounts of domestic and foreign corporations will be the total gross income of the domestic and foreign corporations from all sources (eliminating intercompany transactions) less all the allowable deductions (with intercompany transactions eliminated) to which the corporations would be entitled if they were all domestic corporations. * * * Such construction of Section 240 (d) is not in conflict with the provisions of section 240 relating to consolidated returns of affiliated corporations."

deductions from gross income in computing the consolidated net income upon the basis of which the tax is determined and assessed. (Italics ours.)

An illustration of a practical application of the correct principle is shown in the decision of the Board of Tax Appeals in *Appeal of Standifer Construction Corporation*, 4 B. T. A. 525, 552. There the question directly in issue was whether a deduction attributable to a subsidiary, the Home Company, for the extraordinary amortization of war facilities allowed under the 1918 and 1921 Acts should be applicable against the gross income of the Home Company only, or whether it should be allowed to the affiliated group against the gross income of the group. The Board held the deduction not confined to the Home Company, but allowable against the gross income of the whole affiliated group. The *ratio decidendi* of the decision was stated as follows:

"The fourth question presented is whether the amortization deduction, in so far as it relates to the housing facilities of the Home Company, should be allowed only to that company in determining its net income, or should be allowed the consolidated group or to the Standifer Corporation.

It was contended by both the Commissioner and the taxpayer that the solution of this question rests upon the nature of the consolidated return. The question thus presented is whether, in a consolidated group of corporations, the separate entities are obliterated, or whether the deductions allowed each company are to be deducted from the gross income of each company in arriving at its net income, or, in other words, whether it is the net income and invested capital of each of the companies which are to be included in a consolidated return, or whether it is the income and invested capital of the entire group determined as one business in which the separate entities included therein are fused. * * * [After citing *Appeal of American La Dentelle, Inc.*, 1 B. T. A. 575, and *Appeal of Frank G. Shattuck Co.*, 2 B. T. A. 7.]

The language above quoted sets forth our view with respect to the nature and effect of a consolidated return. It must follow that the amortization deduction is a deduction allowable to the affiliated group of corporations

in a consolidated return. This means, under the circumstances of this case, that the amortization deduction with respect to the housing facilities erected, constructed or acquired by the Home Company should be allowed as a deduction in determining the net income to be included in the consolidated return, irrespective of whether in arriving at such consolidated net income the deduction is in the first instance applied to or by the Home Company."

The decision, based on the same reasoning as were the decisions in *Appeal of Gould Coupler Co.*, 5 B. T. A. 499, *supra*, and *Appeal of Farmers Deposit National Bank*, 5 B. T. A. 520, *supra*, was publicly acquiesced in by the Commissioner of Internal Revenue, the adverse party in the case. See Cumulative Bulletin V-2 (1926), pp. 1, 3. It must therefore be regarded as the Departmental view of the fundamental theory applicable to this sort of case, and, if followed here, must necessitate a reversal of the court below and the allowance of the deduction for statutory net losses of Piedmont Savings Company on the consolidated return against the gross income of the affiliated group.

The court below in this case (53 Fed. (2d) 821) and in the case of *Planters' Cotton Oil Co., Inc.* v. *Hopkins*, 53 Fed. (2d) 825, and the Circuit Court of Appeals for the Second Circuit in *Commissioner of Internal Revenue* v. *Ben Ginsburg Company, Inc.*, 54 Fed. (2d) 238, have decided contrary to the principles here advanced. However, the Circuit Court of Appeals for the Third Circuit in *National Slag Co.* v. *Commissioner of Internal Revenue*, 47 Fed. (2d) 846, the Circuit Court of Appeals for the Fourth Circuit in *Burnet, Commissioner of Internal Revenue* v. *Moore Cotton Mills Co.*, 49 Fed. (2d) 59, and the Board of Tax Appeals in a long line of decisions[1] have held in

[1] *Alabama By-Products Corporation*, 18 B. T. A. 919; *Buckie Printers' Ink Co.*, 19 B. T. A. 943; *Pittsburg Gasoline Co.*, 21 B. T. A. 297; *General Box Corporation*, 22 B. T. A. 725; *Arrow Coal & Ice Company*, 22 B. T. A. 1341; *Tolerton & Warfield Company*, 23 B. T. A. 892; *Hawley Investment Company*, 23 B. T. A. 953.

support of our position, although in the recent case of *Bowman Hotel Corporation* v. *Commissioner*, 24 B. T. A. 1193 (December 19, 1931), involving a New York corporation, where venue on appeal would be in the Second Circuit, the Board followed the Second Circuit decision in the *Ginsburg* case, *supra*, rendered November 2, 1931.[1]

The Circuit Court of Appeals for the Fifth Circuit in this case and in the *Planters Cotton Oil Co.* case seems to have been more disturbed by the metaphysical question of whether there can be "minus net income" than anything else. Suffice it to say in this respect that section 232 of the Act makes "net income" (either plus or minus) a purely statutory result of subtracting from the gross income as defined in section 233 the deductions allowed by sections 234 and 206. Obviously in any case where the deductions exceed the gross income the mathematical result is a minus. What is thus settled by statutory definition should not be disputable.

The court also clearly seems to have insisted on the separate identities of the affiliated group and to have computed the income of each member separately instead of on a consolidated basis. It then reached the view that in any case where the deductions under section 234 of a corporation treated separately exceeded that corporation's gross income, the deduction here claimed could not be allowed. But it will be noted that in this case the Commissioner of Internal Revenue and the Circuit Court of Appeals for the Fifth Circuit have allowed the deductions of Piedmont Savings Company under section 234, to the extent that they exceeded the gross income of Piedmont Savings Company and produced an ordinary loss (or "minus"

[1] We have not treated of the decision of the Court of Claims in the case of *Swift & Co.* v. *United States*, 38 Fed. (2d) 365, because it involved a situation under the 1918 Act, governed by language materially different from that we are concerned with, nor of the decision of the Circuit Court of Appeals for the Second Circuit in *Sweets Company of America* v. *Commissioner*, 40 Fed. (2d) 436, which did not at all involve the question of net losses.

net income) of $453.80, to be applied against the income of the petitioner. The effect is the same as if deductions under section 234 of the one company were applied directly against the gross income of the other. If that is permissible, other deductions, namely those defined by section 206, being placed in the identical category by the Act, must be applied in like manner.

The court also erred grievously in its conception that the consolidated returns provisions could not be regarded as permitting a consolidated group to avail itself of deductions for net losses sustained prior to affiliation by a member. This conception is contrary to the present view and regulations of the Treasury Department, as we later show (*post*, p. 29), and erroneously makes the date of incidence of the deduction controlling as to whether it is to be allowed on a consolidated return. But other statutory deductions, heretofore not questioned on a consolidated return, such as interest on bonds and other indebtedness, compensation for services rendered and the like, as well as amortization of war facilities (see *Appeal of Standifer Construction Company*, 4 B. T. A. 525, *supra*), often have their incidence in obligations or contracts entered into by one of the members of an affiliated group at a time prior to the period when it became a member of the affiliation. If the test to be applied to the question of whether this deduction can be allowed on a consolidated return is that of the date of the incidence of the deduction rather than what the law provides, obviously the same test must be applied to other statutory deductions claimed on a consolidated return. But in that event the law itself must be entirely disregarded and we shall have a tax, not levied on net income determined in accordance with Congressional enactments, but levied under no provision of law, and therefore of doubtful constitutionality.

The Circuit Court of Appeals for the Second Circuit, in the *Ginsburg* case, fell into the error of supposing that the members of the affiliated group are to be regarded as separate entities for

the purpose of computing the tax.[1] As this is a misconception of the fundamental purpose of a consolidated return, it requires no attempt at refutation. The Court also, and as its further reason for its decision, seems to have reached the conclusion that, if the net losses of the affiliated member are to be allowed as deductions to the consolidated group, the effect would be to accumulate net losses beyond the limit contemplated, by using a net loss to compute a further net loss. This error arises from a failure to recognize the statutory definition of a net loss as excluding any possibility of the use of a net loss in the computation of a net loss. (See section 206 (a).)

The decision of the Circuit Court of Appeals for the Fourth Circuit in *Burnet* v. *Moore Cotton Mills Co.*, 49 Fed. (2d) 59, involving a question of the statutory exemption or credit, required a construction of identical language with that here involved, and held that the words "shall be allowed as a deduction in computing net income" mean what we have herein argued they mean.

The Board of Tax Appeals has, in its decisions with respect to the question, with the single exception noted *supra* (page 25), proceeded in accordance with both the express provisions of the Act and the fundamental theory of consolidated returns. Its basic decision on the point is that rendered in *Alabama By-Products Corporation* v. *Commissioner of Internal Revenue*, 18 B. T. A. 919, in which (at pages 920 and 921) it said:

> "* * * [The statutory net loss] is, by the plain language of the statute, put in the same category as any other deduction allowed by statute in determining net income

[1] This is contrary in theory to the ruling of the Bureau of Internal Revenue, I. T. 2355, C. B. VI-1 (1927), p. 98, holding that "Where a tax is assessed upon the basis of a consolidated return, and one of the affiliated companies, on the basis of a separate return, would be entitled to the lower rate of tax allowed domestic insurance companies under the provisions of section 246 (a) 1 of the Revenue Act of 1926, no part of the consolidated net income will be taxable at such lower rate unless the group of affiliated corporations as a whole can qualify as a domestic insurance company."

for the taxable year. It is, for 1920, an allowable deduction from the gross income of the corporation which sustained the loss. An operating loss or deficit of one corporation in an affiliated group, or the amount by which its allowable deductions exceeded its gross income, should be reflected in determining the consolidated net income.

The allowable deductions of the Majestic Coal Co. for 1920, including the excess of its 1919 net loss over its 1918 net income, result in a deductible loss for 1920. This loss should be reflected in determining the consolidated net income of the group. *Gould Coupler Co.*, 5 B. T. A. 499; *H. S. Crocker Co.*, 5 B. T. A. 537."

The Circuit Court of Appeals for the Third Circuit in *National Slag Company* v. *Commissioner of Internal Revenue*, 47 Fed. (2d) 846, 847, after observing that "The answer depends upon the nature of a consolidated return for affiliated companies," and that "The statute [net loss section] does not intimate that its provisions are inapplicable to affiliated corporations," and after showing the fundamental theory of consolidated returns to be as we have urged, stated that the deductions of net losses "come directly within the provisions of the statute which are plain, certain and unambiguous," and decided that the question should be resolved as the petitioner here contends.

The grounds upon which the Board of Tax Appeals, the Circuit Courts of Appeals for the Third Circuit and the Fourth Circuit, and this petitioner, reach their conclusions are supported by the law and the long recognized theory of consolidated returns, and, as we shall next show, are recognized by the Commissioner of Internal Revenue in the present Treasury Department regulations as the correct position.

III.

The present regulations of the Treasury Department are in accord with the position of the petitioner, and, as an administrative interpretation, are entitled to great weight.

The provision of the Revenue Act of 1928, section 141, relating to consolidated returns, differs from the provisions

of prior acts in respect to consolidated returns only in three respects relevant to this case: first, it defines differently what corporations may be regarded as affiliated; second, it requires the affiliated corporations which may file consolidated returns to consent, by the filing of such return, to such regulations as the Commissioner may prescribe with respect thereto; and, third, it provides:

> "(b) Regulations.—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability."

The statute makes no change with respect to what constitutes gross income or what constitute allowable deductions of affiliated corporations. Accordingly, it may properly be concluded that such regulations as the Commissioner, with the approval of the Secretary of the Treasury, has prescribed so "as clearly to reflect the income and prevent avoidance of tax liability" by affiliated corporations are indicative of the Government's mature views as to the correct interpretation of provisions in prior acts, like those here involved, that are in all respects similar in substance.

Pursuant to the provision in the 1928 Act the Treasury Department, on January 3, 1929, promulgated regulations 75, which in Article 41 (c) thereof provides:

> "(c) *Net loss sustained by separate corporation prior to consolidated return period.*
>
> A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income

were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

This regulation is an explicit recognition of the deduction here claimed. It is general in terms and without limitation as to those cases where affiliation arose prior to January 1, 1929. As to those where affiliation should be created after January 1, 1929, the regulation (promulgated on January 3, 1929) put the taxpayer on notice that the deduction would be limited as provided in the last clause of the quoted language; but as to those cases where the affiliated status was created prior to January 1, 1929, there had been no notice and there was no attempted limitation. But the regulation is doubly persuasive because it recognizes the principle we have hereinbefore urged, that it is the "consolidated net income of the group," rather than the separate net incomes of the members summarized, that is the objective in the case of a consolidated return. If any doubt were possible, the language of other subdivisions of Article 41 of Regulations 75 shows beyond question that the income of the consolidated group is treated as that of one single tax computing entity—not several separately determined and summarized;—as, for instance, subdivision (b) of the article speaks of and treats the matter "as if such [consolidated] group were a single corporation." Furthermore, the definition of consolidated net income in the regulations, quoted *ante*, page 13, leaves the matter settled as we submit fundamental principles require it to be.

The reasoning of the court below and of the Circuit Court of Appeals for the Second Circuit in their adverse decisions is based on principles contrary to those long established by administrative construction and by decisions of the Board of Tax Appeals, and is directly in conflict with the specific provisions of Article 41 (c) of Regulations 75, as well as the substance of prior regulations.

Taxpayers have been required by the law to give their

consent in advance, by the filing of a consolidated return, to the provisions of the present regulations. Their returns have for several years been filed on that basis. If the court below and the Circuit Court of Appeals for the Second Circuit are correct, these regulations must be illegal. But what other regulation with respect to the matter could be promulgated that would comport with the fundamental theory and intent of a consolidated return? Obviously these regulations are soundly grounded on principle and the court below is without support in law or fundamental theory.

We deem it unnecessary here, and unduly burdensome, to argue supposititious cases that may, and do, arise in the administration of the consolidated returns provisions. Some of those cases are complicated; they can be solved only by following the theory of consolidated returns that, we respectfully submit, is established by the foregoing authorities and that is recognized and promulgated as the Government's construction by the present regulations. If that theory is departed from, no chart or consistent method exists for application to the varying situations that may arise.

CONCLUSION.

For the reasons above set forth the statutory net losses of the Piedmont Savings Company should be allowed as deductions from the gross income of the affiliated group on the consolidated return of the petitioner and Piedmont Savings Company, and the judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

ALFRED S. WEILL,
HUGH SATTERLEE,
ALBERT S. LISENBY,
Amici Curiae.

WEILL, SATTERLEE, SPENCE & BLAKELY,
Of Counsel.

March 11, 1932.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1931

NO. 582

WOOLFORD REALTY COMPANY, INC., *Petitioner,*

v.

J. T. ROSE, Collector of Internal Revenue for the District of Georgia.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE AND BRIEF OF AMICI CURIAE.

ROBERT N. MILLER,
Southern Building,
Washington, D. C.

JOHN G. BUCHANAN,
Union Trust Building,
Pittsburgh, Pa.
Amici Curiae.

SMITH BROS. CO. INC., LAW PRINTERS, 208-212 GRANT STREET, PITTSBURGH, PA.

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May it please the Court:

The undersigned respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae*.

ROBERT N. MILLER,
JOHN G. BUCHANAN,
Amici Curiae.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1931

NO. 582

WOOLFORD REALTY COMPANY, INC., *Petitioner*,

v.

J. T. ROSE, Collector of Internal Revenue for the District of Georgia.

BRIEF OF AMICI CURIAE.

We believe that this is the first case in which the Court has been required to decide what the effect of a "consolidated return of net income" under the Revenue Acts is. In the lower courts, in the Board of Tax Appeals and in the Treasury Department, while there is a tendency toward uniformity in the interpretation of the phrase, on many important questions the decisions and rulings have been inconsistent. This brief is written on behalf of several affiliated groups of corporations, whose tax returns have for many years involved questions about consolidated returns and, among others, the question presented by the case at bar.

THE QUESTION PRESENTED.

Whether in the computation of consolidated net income subject to tax for the year 1927 there may be deducted net losses sustained by a subsidiary company in the years 1925 and 1926, prior to its affiliation with the petitioner, when such subsidiary company, if it were not so affiliated in 1927, would have had no net income for that year.

SUMMARY OF ARGUMENT.

Affiliated corporations filing a consolidated return should be treated as one entity for the purpose of computing the tax.

A statutory net loss deduction should be treated as any other deduction in making up a consolidated return.

The Treasury Department itself, in its regulations applicable to the taxable year 1929 and subsequent years, follows the rule which the Government opposes here.

ARGUMENT.

Affiliated Corporations Filing a Consolidated Return Should Be Treated as One Entity for the Purpose of Computing the Tax.

Consolidated returns of affiliated corporations were first required by an administrative regulation with reference to the excess profits tax (Treasury Department Regulations 41, Arts. 77-78) promulgated by the Treasury Department pursuant to the War Revenue Act of October 3, 1917 (40 Stat. 300). When the bill (H. R. 12863) which was to become the Revenue Act of 1918 was pending before Congress, the Senate Finance Committee deemed it advisable to incorporate therein, and make applicable to both the income and the excess profits tax, the principle of the consolidated return. In its report to the Senate it stated (Sen. Rep. No. 617, 65th Cong., 3rd Sess., pp. 8, 9) as follows:

> "While the Committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, the Committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the

> revenue, but because the principle of taxing as a business unit is sound and equitable and convenient both to the taxpayer and to the Government."

The proposed Senate amendment became Section 240 of the Revenue Act of 1918 (40 Stat. 1081). The Treasury Department thereupon promulgated regulations for the filing of consolidated returns of net income (Regulations 45, Arts. 631-638). With various changes in detail, these regulations have continued under the several subsequent Revenue Acts. The underlying principle in each new set of regulations has been stated in almost the same terms. To quote from the regulations in force for the taxable year in question in the case at bar (Regulations 69, Art. 631):

> "Consolidated returns are based upon the principle of levying the tax according to the true net income of a single enterprise, even though the business is operated through more than one corporation."

The courts have used language no less emphatic than that which has just been quoted in describing the effect of a consolidated return. Thus, in *Handy & Harman v. Burnet*, 284 U. S. 136, the Court said, by Mr. Justice Butler (p. 140):

> "The purpose of § 240 was, by means of consolidated returns, to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise even though it was conducted by means of more than one corporation."

So also, in *Ice Service Co. v. Commissioner of Internal Revenue*, 30 F. (2d) 230, the Circuit Court of Appeals for the Second Circuit said, by Swan, Circ. J. (p. 231):

> "Congress has declared that two corporations

> shall be treated as one for tax purposes, when one corporation owns or controls substantially all the stock of the other, or when substantially all the stock is owned or controlled by the same interests."

The same theory of the effect of the provision will be found to be set forth in opinions of the courts in all but one of the other Federal Circuits. To avoid unduly cumbering this brief with quotations all to the same purpose, reference is made in a footnote to one case in each of the other circuits, except the First, in which Circuit we are unable to find an applicable case.*

The legislative history of the "consolidated return" provision of the statutes, the repeated administrative interpretation of the provision and the great weight of judicial authority throughout the country bearing upon the matter, all concur in showing that, for the taxable year in which a consolidated return is filed in accordance with the law, the corporations which are parties to it are, for the purpose of determining the amount of their income tax liability, to be treated as a single enterprise.

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*Third Circuit: *National Slag Co. v. Commissioner of Internal Revenue,* 47 F. (2d) 846 (C. C. A.), by Davis, Circ. J., at p. 847.

Fourth Circuit: *Lavenstein Corp. v. Commissioner of Internal Revenue,* 25 F. (2d) 375 (C. C. A.), by Parker, Circ. J., at p. 376.

Fifth Circuit: *Pelican Ice Co. v. Commissioner of Internal Revenue,* 37 F. (2d) 285 (C. C. A.), by Bryan, Circ. J., at p. 286.

Sixth Circuit: *Commissioner of Internal Revenue v. Shillito Realty Co.,* 39 F. (2d) 830 (C. C. A.), by Jones, D. J., at p. 833.

Seventh Circuit: *W. S. Bogle & Co. v. Commissioner of Internal Revenue,* 26 F. (2d) 771 (C. C. A.), by Evans, Circ. J., at p. 772.

Eighth Circuit: *Fidelity National Bank & Trust Co. v. Commissioner of Internal Revenue,* 39 F. (2d) 58 (C. C. A.), by Booth, Circ. J., at p. 61.

Ninth Circuit: *Alameda Investment Co. v. McLaughlin,* 28 F. (2d) 81 (D. C., N. D. Cal.), by Bourquin, D. J., at p. 82; affirmed in *Id. v. Id.,* 33 F. (2d) 120 (C. C. A.).

Tenth Circuit: *Golden Cycle Corp. v. Commissioner of Internal Revenue,* 51 F. (2d) 927 (C. C. A.), by McDermott, Circ. J., at p. 931.

The tax due under a consolidated return (levied on the "consolidated taxable net income" of Art. 635, Regulations 69) is almost always greater or less in amount than the taxes which the constituent companies would have paid, in the aggregate, on a separate return basis. In the calculation of the consolidated net income, two familiar and thoroughly settled incidents, peculiar to the consolidated return, are (1) the elimination of all gain or loss in transactions between the companies participating in the consolidated return and (2) the offsetting of one affiliated company's losses against the gains of another in the same consolidated group. Both of these grow out of the idea that there is but one economic unit—that the tax result should be the same whether the subdivisions of the unit are incorporated or are mere unincorporated branches. The elimination of intercompany gains lessens the tax to be paid; the elimination of intercompany losses increases the tax. Taxes are lessened by offsetting losses of one company against gains made by another; for higher taxes would be due if the companies filing consolidated returns were taxed separately. These differences in amount between the separately computed taxes and the tax computed on a consolidated basis have been regarded as necessary and fair, because, after all, the ultimate ownership of the entire enterprise is the same, no matter whether there is one corporation or more.

In Making Up a Consolidated Return, a Statutory Net Loss Deduction Allowable for 1927 Should Be Treated Like Any Other Deduction Allowable for That Year.

The court below, in the course of its opinion, said:

> *"Of course if appellant is right in its assumption that the statutory net loss deduction must be treated like any other deduction in making up a consolidated return, it is right in its conclusion that it should have had the benefit of it here.* If, on the other hand, as we think, this is a special deduction available only in strict accordance with the terms of the statutes which give it, appellant is wrong and it should have been disallowed." (Italics supplied.)

Section 232 of the Revenue Act of 1926 (44 Stat. 41) provides:

> "In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections *234 and 206*, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226." (Italics supplied.)

In calculating this consolidated net income for 1927 under the two sections mentioned in Section 232, above quoted, we note that under Section 234 there are eleven separately numbered paragraphs providing for deductions, such as expenses, interest, taxes, losses, bad debts, depreciation, depletion. At the beginning Section 234 (a) (44 Stat. 41) reads as follows:

> *"In computing the net income* of a corporation subject to the tax imposed by Section 230 *there shall*

be allowed as deductions: * * *." (Italics supplied).

We then apply the second deduction section which Section 232 mentions—Section 206 (b) (44 Stat. 17), which reads as follows:

> "If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof *shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year* * * *." (Italics supplied).

The problem is merely to find, in accordance with Section 232, what is described by the regulations (Regulations 69, Art. 635) as the "consolidated taxable net income" for 1927. Under the regulations with reference to the consolidated return, the Piedmont Savings Company had no "net income" and could have no "net income" other than "the consolidated net income of the affiliated group" (Regulations 69, Art. 632). The question is, therefore, how the "net loss" which that company admittedly had is to affect the "consolidated net income" of the affiliated group.

It is well settled that if the deductions under Section 234 exceed the gross income of any one of the corporations in an affiliated group, the resulting minus balance is nevertheless reflected in computing the consolidated net income. This principle has been followed by the Commissioner in this case, and there has never been any dispute concerning this practice. Likewise, we submit that, if the deductions allowed under Section 206, either alone or when combined with the deductions allowed under Section 234, exceed the gross income of any one of the corporations of the affiliated group, the resulting minus balance must be reflected in the computation

of the consolidated net income. There is no difference between the provision *"in computing net income there shall be allowed as a deduction,"* and the provision *"there shall be allowed as a deduction in computing the net income."* We believe that the court below was clearly wrong in making a distinction in the treatment of deductions under Sections 234 and 206. The same principle of consolidation which properly reduces the tax by offsetting a loss or deficit of one corporation against gains of another which is in the same consolidated group, continues to apply, no matter which of the various authorized "deductions," available for the taxable year in question, accounts for the loss.

The significant facts here are that, after using all the statutory deductions which are allowable in 1927 under Sections 234 and 206, one of the constituent companies shows a loss, that another of the companies shows a gain for the same year, and that 1927 is a year when the corporations in question are allowed to file, and do file, a consolidated return. The fact that some or all of the losses which (under the applicable law) constitute deductions in 1927, came from 1926, or some other year, does not oppose the conclusion that, in the 1927 consolidated return, there shall be the usual offsetting (characteristic of consolidated returns) of the deficit shown by one company against gains shown by other companies of the group.

The Treasury Department Itself, in Its Regulations Applicable to the Taxable Year 1929 and Subsequent Years, Recognizes that a Net Loss Sustained by a Corporation prior to Affiliation Should Be Taken into Consideration in Computing Consolidated Net Income after Affiliation.

No regulation specifically dealing with the state of facts involved in the case at bar was ever promulgated by the Treasury Department until the publication of Regulations 75, Art. 41 (c), approved January 3, 1929. That regulation reads as follows:

> "A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

Under Section 141 (a) of the Revenue Act of 1928 (45 Stat. 831) an affiliated group of corporations have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year only "upon the condition that all the corporations * * * consent to all the regulations under subsection (b) prescribed prior to the making of such return." Under this provision the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is practically given the power of Congress to lay down the

terms upon which a "consolidated return" for one of the years mentioned may be filed. It is to be observed that the Treasury Department, when it was given this new and wider power, concluded that it would be wrong to deprive the consolidated group of the benefit of any net loss sustained prior to January 1, 1929. In the regulation then promulgated, no limitation whatever was placed on the application of the net loss deduction when the affiliated status was created before January 1, 1929, and even in cases where the affiliated status was created after that date the limitation was no such drastic limitation as that which the Government, without any regulation, argues for here. The Department recognizes that the deduction is the deduction of the affiliated group as a whole, not of one of its members merely; and, in a case where the net loss was incurred, as in the case at bar, prior to January 1, 1929, the Department gives full effect thereto as a deduction from the net income of the group. This result is arrived at under a statutory provision with regard to net losses (Section 117 (b) of the Revenue Act of 1928, 45 Stat. 825) copied verbatim from the provision of the Revenue Act of 1926 involved in the case at bar. Under these circumstances it may well be asked, Why should the Treasury Department litigate in a number of jurisdictions a question which it has itself answered conformably to the position taken by taxpayers? We submit that it should not. But suppose that the Treasury Department, let us say because it is uncertain as to the correctness of the answer which it gave to the question in promulgating its 1929 regulations, is justified in continuing the litigation. Nevertheless, we confidently submit that the court below was wrong. It had no power to prescribe regulations like that given to the Treasury Department as to 1929 and later years by the Revenue Act of 1928. Yet we submit, in view of the

recognition of the correctness of the taxpayer's position by those regulations, and in view of the whole history of the "consolidated return" provision, that the court below really legislated in order to render ineffectual in determining consolidated net income the deduction of a net loss allowable to the taxable entity. Such judicial legislation cannot be justified merely because the net loss was incurred by a corporation prior to affiliation which, as it happened, would have had no net income if it had not been (as it was) a member of a group of corporations filing a consolidated return.

Conclusion.

It is submitted, therefore, that the whole history of net losses of parties to a consolidated return down to the latest regulation on the subject shows that the decisions of the learned court below in this case and in the case of *Planters Cotton Oil Co. v. Hopkins,* 53 F. (2d) 825, and of the Circuit Court of Appeals for the Second Circuit in *Commissioner of Internal Revenue v. Ben Ginsburg Co.,* 54 F. (2d) 238, were wrong and the decision of the Circuit Court of Appeals for the Third Circuit in *National Slag Co. v. Commissioner of Internal Revenue,* 47 F. (2d) 846, was right.

Respectfully submitted,

ROBERT N. MILLER,
JOHN G. BUCHANAN,
Amici Curiae.

FILE COPY

APR 18

In The Supreme Court of The United States

October Term, 1931

No. 582

WOOLFORD REALTY COMPANY, INC.,
Petitioner,

vs.

J. T. ROSE, Collector of Internal Revenue
for the District of Georgia

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

MOTION FOR LEAVE TO FILE MEMORANDUM AS AMICI CURIAE

AND

MEMORANDUM OF AMICI CURIAE

KINGMAN BREWSTER
JAMES S. Y. IVINS
PERCY W. PHILLIPS
Amici Curiae
c/o Brewster, Ivins & Phillips,
805 Fifteenth Street, N.W.,
Washington, D. C.

Of Counsel:
O. R. FOLSOM-JONES
RICHARD B. BARKER

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MOTION FOR LEAVE TO FILE MEMORANDUM AS AMICI CURIAE

May It Please The Court:

The undersigned, as counsel for The New York, New Haven and Hartford Railroad Company, the Boston & Maine Railroad, the Carnation Milk Company, and The Ohio Oil Company, which have cases in litigation and before the Bureau of Internal Revenue involving questions of carrying forward net losses under the Revenue Acts, similar to the issue presented in the instant case, respectfully move this Honorable Court for leave to file the accompanying memorandum in this case as *amici curiae*.

KINGMAN BREWSTER
JAMES S. Y. IVINS
PERCY W. PHILLIPS

In The Supreme Court of The United States

October Term, 1931.

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WOOLFORD REALTY COMPANY, INC.,
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MEMORANDUM

I.

Under Section 206 (b) of the Revenue Act of 1926, the unabsorbed statutory net loss of a company for a prior year, whether or not such company was then affiliated, should be deducted from gross income of the current taxable year, when the company is affiliated with another, to arrive at net income, or net loss, as the case may be.

The Treasury Department's position regarding the issue in the instant case may be stated by the following quotation from page 5 of the Government's brief:

"Hence an affiliated group may take advantage of net losses suffered by a member before

affiliation only to the extent that the member had net income for the taxable year for which the consolidated return is filed."

The Department in practice applies the same rule even where the member of the affiliated group for the taxable year was also affiliated in the same group for the prior year in which occurred the net loss which is to be carried forward as a deduction in computing net income. The Department's interpretation of the net loss provisions of the Revenue Act of 1926 is erroneous whether the application of the statute be to a situation where the member of the affiliated group (having the net loss to carry forward) was affiliated in the prior year or was not affiliated in such prior year. When applied to a situation where the companies in the group were affiliated in both the year for which the net loss of one of its members was incurred and in the subsequent year to which the net loss is carried, the error in the Department's practice is most patently shown.

Section 232 of the statute defines the term "net income" as meaning the gross income less the deductions allowed by Sections 234 and 206. Section 234 provides for the deduction of certain expenses, losses, bad debts, and allowances in computing the net income of a corporation. Section 206 (b) provides that if for any taxable year it appears that any taxpayer sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net in-

come of the taxpayer for the succeeding taxable year, and if such net loss is in excess of the net income (if any) for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year.

The provisions in Section 206 (b) allowing a net loss of a prior year to be carried forward as a deduction in computing net income of the succeeding taxable year is of the same import as the provision in Section 234 of the Act allowing numerous specified items to be deducted in computing the net income of a corporation. The Department permits any member of an affiliated group for a taxable year to deduct from gross income all items allowed by Section 234 of the Act, even when that results in a current net loss. Such loss under the Department's practice is deducted from the net income of other members of the affiliated group in order to arrive at consolidated net income. The other deduction, allowed by Section 206 (b), should equally be permitted in full as a deduction from gross income even if it results in a current net loss for the member of the affiliated group. Such current net loss of the member should be deducted from the income of the other members of the affiliated group in arriving at consolidated net income, exactly as losses resulting from deductions under Section 234 are allowed.

Until all deductions from gross income allowed by the statute have been made, the taxpayer cannot

Revenue Acts, was first stated definitely in the report of the Senate Finance Committee in connection with the Revenue Bill for 1918:

> "Provision has been made in section 240 for a consolidated return, in the case of affiliated corporations, for purposes both of income and profits taxes. A year's trial of the consolidated return under the existing law demonstrated the advisability of conferring upon the Commissioner explicit authority to require such returns.
>
> "So far as its immediate effect is concerned a consolidation increases the tax in some cases and reduces it in other cases, but its general and permanent effect is to prevent evasions which can not be blocked in any other way. * * * While the committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because the principle of taxing as a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government." (Senate Report 617, accompanying H. R. 12863, Dec. 6, 1918, 65th Congress, 3rd session, pp. 8–9).

It is only in a rare instance that one member of an affiliated group of companies sustains a net loss that is not in some part caused by its relation to the other companies of the group, and this would ordinarily not be due to any artificial arrangement between them. For instance, a railroad company may be compelled by public demand to operate a branch line, even at a recurring annual loss. The loss should be

offset by the profits from the rest of the system whether the branch line is separately incorporated or not.

The Department concedes that the loss shown for Company C in the illustration given above for the first taxable year is deductible from the net income of the other two companies. There is no proper reason why the parent company of an affiliated group having net income in both years, should not have the benefit in the succeeding taxable year, either directly or indirectly, of carrying forward an unabsorbed statutory net loss of an affiliated company for a prior year, just as much as it is entitled to the benefit of reduction of its income in the prior year by the loss of the affiliated company in that prior year.

Respectfully submitted,

KINGMAN BREWSTER
JAMES S. Y. IVINS
PERCY W. PHILLIPS
Amici Curiae.

Of Counsel:
O. R. FOLSOM-JONES
RICHARD B. BARKER

know whether there is net income or loss for such year. After the items in Sections 206 and 234 have been deducted and a loss results, there is no provision for them going back and disallowing certain deductions, whether they were allowed under Section 206 or Section 234, in order to eliminate any net loss resulting therefrom.

The Circuit Court of Appeals for the Fourth Circuit in *Burnet* v. *Moore Cotton Mills Co.*, 49 Fed. (2d) 59, in reviewing the decision of the United States Board of Tax Appeals in that case (17 B. T. A. 662), cited with approval the conclusion of the Board and its comment on Article 1602 of Treasury Regulations 62. That case dealt with a net loss provision in Section 204 (b) of the Revenue Act of 1921 which as to the "next succeeding (third) taxable year" had a provision similar to that in Section 206 (b) of the Revenue Act of 1926. The following quotation from the Board's decision was especially commented upon favorably by the Circuit Court of Appeals:

> "We find no ambiguity in either the first part or in any part of section 204 (b) of the Act of 1921. On the contrary, its provisions seem to us to be as clearly specific and unmistakable as it is possible to express them. Without doubt the Commissioner is endowed with the power to make and enforce regulations that shall carry out the clear intent of the words of this section, but equally the power given in the section does not imply that he has any authority to make or enforce any regulation that alters, or even modifies, that clear intent, and it would be without

effect even though that were the implication. The power of Federal legislation lies solely in Congress, and in our opinion that part of the regulation of the Commissioner which we have italicized and which provides that the excess of the net loss over the net income of the second year 'shall be carried over and credited against the net income for the next succeeding (third) taxable year' where Congress has clearly provided that 'the amount of such excess *shall* be allowed *as a deduction in computing the net income* for the next succeeding taxable year,' is an erroneous construction of that Act and goes beyond the power delegated to the Commissioner. We do not know whether it was the intent of Congress to provide that the deductions permitted, under certain circumstances, for the second and third years should be similarly applied; but we do know that such is not the effect of the language used in section 204 (b) of the Revenue Act of 1921; and that it is not within the power of the Commissioner so to construe and apply the widely differing provisions therein contained. The rule has been so well settled that it seems unnecessary further to discuss it or to cite authorities."

The Government's brief mentions the decision of the Court of Claims in *Swift & Co.* v. *United States*, 38 Fed. (2d) 365, as upholding its position in the instant case. We point out, however, that the Court of Claims decision had to do with an entirely different provision phrased in different language than the net loss provision in the Revenue Act of 1926. In the *Swift & Company* case the court was only concerned with applying the net loss for 1919 therein involved, *as a deduction* from *the net income* (i.e., after it is

determined) of the preceding taxable year (1918) under the Revenue Act of 1918, whereas in the present Woolford Realty Company case the Revenue Act of 1926 provides that the net loss shall be carried forward *as a deduction* in computing *the net income* (i.e., before it is determined) of the succeeding taxable year. In the instant case, the net income cannot be computed until the net loss has been deducted, while in the *Swift & Company* case, the net income was first ascertained and the net loss allowed in the nature of an offset or credit.

II.

Prior Decisions Discussed

The United States Board of Tax Appeals has consistently overruled the Department's present position in a long line of decisions:

> "The net loss of one of the affiliated corporations for the year 1926, at which time it was not a member of the affiliated group, operates to reduce the consolidated net income for the year 1927 under Section 206 (b) of the Revenue Act of 1926, even though such corporation having the net loss in 1926 also had a net loss in 1927."

Hawley Investment Co. 23 B. T. A. 953. See also *Alabama By-Products Corporation, et al.*, 18 B. T. A. 1919; *Ben Ginsburg Co.*, 19 B. T. A. 81,[1] *Buckie*

[1] Reversed (C. C. A. 2d) 54 Fed. (2d) 238. Following this reversal, the Board, in a case arising from the Second Circuit, has felt bound to follow the decision of the Circuit Court of Appeals. *Bowman Hotel Corporation*, 24 B. T. A. 1193. Otherwise the Board has been consistent in its conclusions.

Printers' Ink Co., 19 B. T. A. 943; *Pittsburgh Gasoline Co.*, 21 B. T. A. 297; *General Box Corporation*, 22 B. T. A. 725, 731.

To the same effect, *Burnet* v. *Moore Cotton Mills Co.*, *supra*, a decision by the Circuit Court of Appeals for the Fourth Circuit, as aforesaid, and *National Slag Co.* v. *Commissioner*, 47 Fed. (2d) 846, a decision by the Circuit Court of Appeals for the Third Circuit.

III.

An illustration and discussion of cases where the company, having a statutory net loss in a prior year to be deducted from gross income of the current taxable year, was a member of the affiliated group in both taxable years—to show the error of the Department's present practice.

The situation presented in the cases of The New York, New Haven and Hartford Railroad Company, the Boston & Maine Railroad and The Ohio Oil Company, for which the undersigned are counsel may be illustrated as follows:

	Affiliated in First Taxable Year	Affiliated in Succeeding Taxable Year
Company A—net income...	$100,000	$100,000
Company B—net income...	50,000	50,000
Company C—*net losses*.....	*250,000*	*50,000*
Consolidated loss.....	*$100,000*	
Consolidated gain.....		$100,000

We must assume for the illustration above set forth that the net loss of Company C for the first taxable year is the statutory net loss defined by Section 206 (b) of the Revenue Act. It is a quite generally accepted practice[1] to determine the amount of net loss for the first taxable year of any member of the affiliated group, to be carried forward, by deducting therefrom the net income of the other member or members of the affiliated group for the same year. In a case where there are several companies having a net loss in an affiliated group for the first taxable year, each company having loss absorbs its aliquot portion of the net income of the other companies. The unabsorbed statutory net loss of Company C in the above illustration, therefore, is $100,000 which

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[1] The Court of Claims in *Swift & Co.* v. *United States*, *supra*, in this connection stated:

"The answer to this is that in such a case, for the purpose of computation, section 240 [providing for affiliation] is a limitation of section 204 [the net loss provision of the Revenue Act of 1921] and that, in the computation under section 240, losses of one company must be offset against the income of the other companies before it can be determined whether there is a net loss of any company in 1919 which may be applied against its income for 1918. Obviously, if this were not done, the net loss which had been used to offset the income of the other companies in the consolidated group would be allowed again to reduce the income of the company which sustained the loss when applying it to the income of the prior year, and we think Congress did not intend a double deduction of this character."

Also see footnote "3" in the Court of Claims case; and likewise *General Box Corporation*, 22 B. T. A. 725, 731.

should be carried forward as a deduction in computing the net income of the succeeding taxable year.

The Department under its present rule, however, would not allow that amount of $100,000 as a deduction at all in the second taxable year. It would determine the consolidated net income for the succeeding taxable year at $100,000. If the loss can be carried forward, as the petitioner herein contends, there would be no consolidated net income for the succeeding taxable year upon which tax would be imposed.

We submit that the net loss provisions contemplate that there should be no consolidated net income for tax purposes for the taxable year where, in fact, as in the illustration above given, the operations of the two years have resulted in no real gain.

The Court of Claims in the case of *Swift & Co.* v. *United States, supra,* held that "the separate corporations are the taxpayer, and the affiliated group is merely a tax-computing unit, not a taxable unit."

As the court stated—

> "The consolidated group, as such, is not a taxpayer but a tax-computing unit, and the corporations which are members of the affiliated group for the year, or became members during the year, lose their separate identity while so affiliated only for the purpose of computation of the tax upon one income and one invested capital which is composed of the income and invested capital of such corporations combined, * * *."

Thus while the decisions have indicated that the carry-over of net loss and the computation therewith of net income or loss for the succeeding taxable year should be made with respect to each company within the affiliated group, and subsequently that the net incomes and losses of all the companies should be combined to arrive at consolidated net income, this procedure in substance is not different from combining the gross income of all the companies in the first instance and allowing therefrom the combined deductions of all the companies including the carry-over of net losses from prior years. Of course inter-company items in either event are eliminated and net loss will be carried over as a deduction in computing net income only to the extent that companies having the loss in prior years are within the affiliation for the succeeding taxable year. The result by either procedure is the same, and the court in the *Swift & Company* case, *supra*, so indicates—

> "In the enactment of section 240, Congress was simply laying down the principle that where a group of companies constituted a single business unit, the net income, determined in accordance with the general principles of law, should be *combined*, losses being offset against gains, and the *rate of tax* should be determined by the relation between such combined net income and the invested capital of the group as a whole, each corporation being at all times separately recognized and individually liable for its proportion of the tax according to the net income properly assignable to it."

Article 631 of Regulations 69 similarly provides:

> "Consolidated returns are based upon the principle of levying the tax according to the true net income of a single enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the net income of the branch forms a part of the net income of the entire organization."

Whether the taxable income or loss of the consolidated group for the succeeding taxable year is to be determined by combining the gross income of all the companies and subtracting therefrom the combined deductions of such companies, or the net income or loss of each company is first to be determined and thereafter added to or deducted from the incomes of the other companies to arrive at consolidated net income, each company within the group is entitled under the statute to the benefit of all deductions provided by law. These deductions include the unabsorbed statutory net loss of the prior year which is just as much a deduction in computing net income or loss for the succeeding taxable year as the deductions allowable under Section 234.

The real reason for affiliation and consolidated returns, provided for by Section 240 of the various

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1931

No. 582

WOOLFORD REALTY COMPANY, INC., *Petitioner,*

v.

J. T. ROSE, *Collector of Internal Revenue For The District of Georgia.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE

May it please the Court:

The undersigned respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae.*

FREDERICK L. PEARCE
GEORGE M. MORRIS
Amici Curiae,

IN THE

Supreme Court of the United States

OCTOBER TERM, 1931

No. 582

WOOLFORD REALTY COMPANY, INC., *Petitioner,*

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J. T. ROSE, *Collector of Internal Revenue For The District of Georgia.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF FREDERICK L. PEARCE AND GEORGE M. MORRIS AS AMICI CURIAE

I. THE PURPOSE OF THIS BRIEF.

The respondent in his brief herein would infer that, in cases where a consolidated return is made (under Section 240), there is something inequitable in the application of net losses under the statute by the method contended for by the appellant taxpayer. The present brief is confined to a demonstration by illustrative computations taken from actual cases that more inequities result from the respondent's method of applying net losses, and that the taxpayer's method will produce an equitable result in the great number of consolidated returns.

II. THE METHODS PROPOSED FOR APPLYING NET LOSSES IN CONSOLIDATED CASES.

In view of the able discussion of the statute in other briefs amici curiae filed in this proceeding, a technical presentation of the two theories is not contemplated herein. A summary description of the two opposing views is, however, a necessary precedent to an understanding of the contrasting application of net losses to the varying circumstances of consolidated returns. For the sake of simplicity the examples are in general confined to a consideration of two corporations merely for two successive years; the injection of a third year would not change the effects of the two proposals. The methods contended for by the opposing parties hereto, are summarized as follows:

1. *The Respondent's Method.*

The respondent contends for a rule that:

The net losses of Companies A and B for 1926 are to be carried forward (under Section 206) and the separate net loss of each company is to be applied against the net income (if any) of each respective company for the year 1927. If after such application of net losses Company A has net income remaining in 1927 and Company B has net loss unabsorbed, that loss of B may *not* be combined with the remaining income of A in determining (under Section 240) the taxable net income on a consolidated basis for the year 1927.

2. *The Taxpayer's Method.*

The taxpayer contends for a rule that:

The net losses of Companies A and B for 1926 are to be carried forward (under Section 206) and the separate

net loss of each company is to be applied (under Section 232) as a deduction in computing the net income (and ordinary loss) of each respective company for 1927. If such computation (under Section 232) for 1927 results in net income for Company A and ordinary loss (excess of deductions over gross income) for Company B, that loss of B for 1927 is to be combined with the net income of A in determining (under Section 240) the taxable net income on a consolidated basis for the year 1927.

3. *The Contrast of the Two Proposals.*

Both parties appear to agree upon the separate carrying forward of net losses under Section 206, but they disagree upon the application thereof to be made under Section 232. If ordinary loss (negative income) results to Company B under Section 232 from deductions authorized by Section 234 (for interest, taxes, expenses, etc.), the respondent will combine such loss of B with the net income of A in determining consolidated net income (under Section 240). If ordinary loss (negative income) results to Company B (under Section 232) from the deduction authorized by Section 206 (for net loss), the respondent refuses to combine such loss of B with the net income of A in determining consolidated net income (under Section 240).

The respondent thus makes two different applications of Section 232 in his computations under Section 240. The respondent, in his brief, bases his refusal to make the same application of Section 240 to both types of negative income resulting under Section 232, upon the argument (we submit mistaken) that there is something inequitable in combining an ordinary loss of one company (resulting from a net loss) with the net income of the other company in the group in determining consolidated net income.

The following presentation of actual cases arising under Section 240 we believe clearly demonstrates that more inequities result from the respondent's proposed method of applying net losses, and that the taxpayer's method more closely following the statute, will produce an equitable result in the great number of consolidated returns.

III. IN CERTAIN CONSOLIDATED CASES THE SAME RESULT IS REACHED UNDER BOTH PROPOSED METHODS.

In a large number of cases arising under Section 240 the same resulting consolidated net income is arrived at under both proposed methods of applying net loss. Obviously these examples do not bring out the contrast of the two methods but they do serve to show what the respondent believes is a proper result under the statute.

Example 1.

The Facts.—In 1926 Company A owned no stock of Company B; the two companies sustained net losses of $10,000 and $11,000 respectively. On January 1, 1927, Company A buys all the stock of B, and they earn net incomes of $10,000 and $11,000 respectively in that year.

The taxable net income on the consolidated return for 1927 is computed under both proposed methods as follows:

Co. A—Net Loss 1926	$(10,000)	
Net Income 1927	10,000	
Net Income remaining 1927		None

Co. B—Net Loss 1926	$(11,000)
Net Income 1927	11,000
Net Income remaining 1927	None
Consolidated Net Income 1927	None

In regard to the application of the respondent's method see General Counsel's Memorandum 8618 (IX-2 Cumulative Bulletin p. 180) at page 182 (point 4 of Law Opinion 1113) where the corporations were not affiliated in the year of net loss but were affiliated in the year of the application, the net loss of each is allowed to be carried over to the extent that the same company had income. At the top of page 184, point 4 is approved in principle.

Thus the very result which the respondent objects to on equitable grounds in the Woolford Case, occurs in the group of cases covered by this example. The net loss of Company B for 1926 which really fell upon its former stockholders in that year is allowed in 1927 to the benefit of the parent Company A and its stockholders. The respondent reaches this result, despite his equitable theory, evidently because the statute requires such application of the prior net losses.

Example 2.

The Facts.—Company A owned all the stock of Company B and filed a consolidated return in 1926; A earned $10,000 and B sustained a net loss of $21,000 in that year. On January 1, 1927, the parent A sells all the stock of B to strangers, and the

two companies earn net incomes of $11,000 and $12,000 respectively for 1927.

The application of the net loss is made under both proposals as follows:

1926—Co. A Net Income	$10,000	
Co. B Net Loss	(21,000)	
Consolidated Net Loss (Sec. 240) applicable to Co. B (Sec. 206)		$(11,000)
1927—Co. A Net Income	$11,000	
Net Loss from 1926	none	
Taxable Net Income Co. A 1927		$11,000
1927—Co. B Net Income	$12,000	
Net Loss from 1926	(11,000)	
Taxable Net Income Co. B. 1927		$1,000

For respondent's method see G. C. M. 8618 (IX-2 Cumulative Bulletin p. 180) at page 182 (point 3 (b) of Law Opinion 1113) where the corporations were affiliated in the year of the net loss but were not affiliated in the year of the application, the net loss on the consolidated return is apportioned to the member which separately had a net loss and applied against its net income in the other year. Point 3 is approved at the top of page 184.

Here again the result reached in this group of cases is inconsistent with the respondent's supposed equitable theory. The parent Company A, whose money was lost in 1926 through the operations of its subsidiary B in that year, receives no benefit of the net loss for 1926 in its return for 1927. The new stockholders of Company B

in 1927, however, receive the benefit in 1927 of the 1926 loss in which they had no direct or indirect interest. We must conclude, therefore, that even in the opinion of the respondent the equities, if there be any such considerations, must give precedence to the specific provisions of the statute regarding net losses.

In reality, it should be clear from these examples that the supposed equitable argument of the respondent is not inherent in his method of applying net losses but is a mere happenstance in certain cases and has no reference to the general application of his proposed method.

Example 3.

The Facts.—Company A owned all the stock of Company B and filed consolidated returns for both years 1926 and 1927. The two companies sustained net losses of $10,000 and $11,000 respectively in 1926 and earned net incomes of $10,000 and $11,000 respectively in 1927.

The taxable net income on the consolidated return for 1927 is computed under both proposed methods as follows:

Co. A—Net Loss 1926	$(10,000)	
Net Income 1927	10,000	
Net income remaining 1927		None
Co. B—Net Loss 1926	$(11,000)	
Net Income 1927	11,000	
Net income remaining 1927		None
Consolidated Net Income 1927		None

For respondent's method see G. C. M. 8618 (IX-2 C. B. 180, at p. 188) "In summarizing, the net loss allocable

to members of the group for * * * (1926) may be brought forward and deducted from the net income allocated to the member for * * *" (1927).

The result here under either method obviously, from the unchanged interest, accords with the equities of the situation, and this example is included for sake of completeness since it represents a large group of cases. We must point out, however, that the result does not arise from the equity of the affiliation and continuing interest for the same result is reached under the respondent's method in Example 1 (supra) where the companies were not affiliated in 1926 and the interest was radically changed in 1927.

We might multiply the examples wherein both parties to the present cause are in agreement as to the application of net losses in consolidated cases. We believe it is clear, however, from the foregoing examples which cover large groups of consolidated returns, that the equity of the result reached is not inherent in the method employed but arises merely as a necessary resultant of applying the provisions of the statute.

IV. EXAMPLES OF HARDSHIP PRODUCED BY THE RESPONDENT'S METHOD.

There are numerous cases arising under Section 240 in which quite opposite results are reached under the two methods proposed, by the parties to the present proceeding, for applying net losses in consolidated returns. In large groups of such cases the respondent's proposal clearly results in hardship, while the taxpayer's proposed method, more closely following the statute, reaches an equitable result in the great number of consolidated returns.

A few examples of large groups of such cases are set

out below, and the result reached under the respondent's method of applying net losses is contrasted with the effect of the method proposed under the statute by the appellant taxpayer.

Example 4.

The Facts.—Company A owned all the stock of Company B, and filed consolidated returns for both years 1926 and 1927. The two companies sustained net losses of $10,000 and $11,000 respectively in 1926. Company A earned net income of $33,000 in 1927 while Company B sustained a loss (for that year alone) of $12,000.

The taxable net income on the consolidated return for 1927 is computed under the respondent's proposed method as follows:

Co. A Net Income 1927	$33,000	
Net Loss 1926	(10,000)	
Net Income remaining 1927		$23,000
Co. B Loss 1927 alone	$(12,000)	
Net Loss 1926 ($11,000)	not applied*	
Ordinary loss for 1927 (alone)		12,000
Consolidated Net Income 1927 return		$11,000

* In G. C. M. 8618 (IX-2 C. B. p. 180) at page 188, last paragraph, it is ruled that "such (1926) net loss may not be used as a deduction in * * * (1927) beyond the point where there is income of the member to absorb it."

The respondent, by not permitting the net loss of Co. B for 1926 to be deducted with the loss for 1927 alone in

computing the ordinary loss of that company (under Section 232) for 1927, deprives the continuing group of the benefit of the losses sustained by it in the prior year. The losses through the operations of the subsidiary B must eventually fall upon its parent A through the stock relationship and in all equity should be absorbed against the profits of the parent.

The following result under the taxpayer's proposed method is more equitable:

Co. A Net Income 1927	$33,000	
Net Loss 1926	(10,000)	
Net Income remaining 1927		$23,000
Co. B. Loss 1927 alone	$(12,000)	
Net Loss 1926	(11,000)	
Ordinary Loss for 1927 (Sec. 232)		(23,000)
Consolidated Net Income 1927 *Return*		None

This example obviously covers a large group of consolidated returns. It is frequently necessary for a parent corporation to operate a subsidiary company at a loss year after year because that subsidiary performs a function necessary to the group, and its operation even at a loss contributes to the larger profits of the group as a whole.

Take the case of a parent mining corporation owning a short line railroad essential as an outlet for the mine. Without the railroad the mine cannot operate, yet the rates of the railroad may be so fixed in the public interest (by regulating authority) that the railroad must operate each year at a loss. The parent would not continue to operate the railroad if that operation did not contribute to the profitable conduct of the mining venture.

For many reasons, under the requirements of state laws or due to the internal arrangements of the business as a whole, many a parent company must as a matter of good business continue to conduct a subsidiary at a loss. The subsidiary may be required to hold title to real estate in a foreign state, or to perform a service function such as a railway, electric, gas, or water company, warehousing or distributing agency, which is essential to the business as a whole. An endless number of such elements of business operations are better performed by a subsidiary than by the parent itself.

Yet if the subsidiary Company B happens to sustain net losses in both 1926 and 1927, while the parent has a net loss in 1926 and sufficient income in 1927 to absorb the losses, the respondent's proposed method denies deduction of the net loss of the subsidiary B for the year 1926. Clearly it is the parent's money which is lost through the subsidiary operations and in all equity the loss of B for 1926 is just as much a part of the consolidated return as is A's loss for 1926, or B's loss for 1927.

In this large group of cases arising under Section 240, the method proposed by the taxpayer, specifically following the statute in the application of net losses, produces also the equitable result; the respondent's method, ignoring the provisions of section 232, results in hardship and inequity in a great number of consolidated returns.

Example 5.

The Facts.—Company A owned 94% of the stock of Company B in 1926; the two companies sustained net losses of $10,000 and $11,000 respectively in that year. On January 1, 1927, Company A

buys an additional 1% of the stock of Company B and in that year Company A earns net income of $33,000 while Company B sustains a loss (for that year alone) of $12,000.

The taxable net income upon the consolidated return for 1927 is computed under the respondent's method of applying net losses, as follows:

Co. A	Net Income 1927	$33,000	
	Net Loss 1926	(10,000)	
	Net Income remaining 1927		$23,000
Co. B	Loss 1927 alone	$(12,000)	
	Net Loss 1926 ($11,000) not applied*		
	Ordinary Loss 1927 (alone)		(12,000)
	Consolidated Net Income 1927 *return*		$11,000

* In G. C. M. 8618 (IX-2 C. B. p. 180) at page 182 (point 4 of Law Opinion 1113) where the corporations were not affiliated in the year of the loss but were in the year of application, if the net loss of a member exceeds its proportion of the consolidated net income in the other year the excess shall not be allowed to further reduce the consolidated net income. Point 4 is approved at top of page 184.

Here again the respondent denies the deduction for the loss of the subsidiary B for the year 1926 although that loss for practical purposes falls upon the parent Company A and in all equity should be absorbed against its profits.

The following result under the taxpayer's method of

applying net losses is more in accordance with the practical consequences and equities of the situation:

Co. A Net Income 1927	$33,000	
Net Loss 1926	(10,000)	
Net Income remaining 1927		$23,000
Co. B Loss 1927 alone	$(12,000)	
Net Loss 1926	(11,000)	
Ordinary Loss 1927 (Sec. 232)		(23,000)
Consolidated Net Income 1927 *return*		None

Practical commercial accounting requires the consolidation of a subsidiary's loss with the parent when only a majority control is owned. In many cases a large commercial control is owned for years before the gradual acquisitions of the subsidiary's stock reach an ownership of 95% by the parent. Meanwhile the parent finances the subsidiary and for practical purposes bears its losses.

It is only when 95% ownership of the subsidiary stock is attained that its losses may be brought into the consolidated return with the parent. Yet even then the respondent would refuse to bring forward the loss of the subsidiary for the preceding year (although this is provided for in Sections 206 and 232) and although that loss has already fallen upon the parent for all practical purposes through the parent's ownership of controlling stock in the subsidiary.

Consolidations in which the parent company owns slightly under 95% in one year and attains over 95% ownership of the subsidiary's stock in the next year are quite numerous. The mining company mentioned in

Example 4 (supra) may own all but a 6% minority in the railroad (or other such subsidiary) in 1926, and acquire some of the minority stock in 1927. The service rendering subsidiary is no more an essential part of the business group as a whole in 1927 than it was in 1926. The railroad contributes no more effectively to the operations and success of the parent mine when 95% of the stock is attained than when only 94% was owned. The practical commercial considerations requiring the continued operations of the subsidiary even at a loss are in either case just as compelling and the loss of the subsidiary is for all practical purposes the loss of the parent.

Frequently the parent company will own 100% of the common stock of a subsidiary, with a small issue of voting preferred stock in the hands of the public. Because such holders will not sell at a fair price, or because the retirement date has not been reached, the parent cannot acquire such preferred stock. Yet consolidation is denied so long as over 5% of the total voting stock is outstanding. If in 1927 the preferred stock be retired, consolidation is permitted. Yet the respondent would refuse the carrying forward of the subsidiary's loss for 1926 even though it had already fallen upon the parent because of its continuing ownership of all the common stock. Such loss would seem clearly and equitably to be a proper factor in the determination of actual net income upon a consolidated basis.

Another large class of cases in this group includes subsidiaries in which a minority of stock is sold at par to employes (such as the manager of the department operated by the subsidiary). Such stock is sold to stimulate loyalty in the employes with the hope of profit sharing. After several years of unsuccessful operations the parent is compelled to repurchase the employes' stock, and, to

retain their loyalty, repurchases such stock at the price the employes paid for it. Such repurchase is good business but it effectively throws the accumulated loss of the subsidiary upon the parent. (The foregoing are the basic facts in Summerfield Co. v. Commissioner, 24 B. T. A. 829).

Here again the respondent's proposal precludes the consolidation of the prior losses; the taxpayer's method permits the inclusion of the subsidiaries' losses (for the years covered by Sections 206 and 232). We submit the latter method is more in accord with the practical consequences and equities of the situation.

Example 6.

The Facts.—Mr. S owned all the stock of Companies A and B in 1926; they sustained net losses of $10,000 and $11,000 respectively in that year and did not elect to file a consolidated return. On January 1, 1927, Mr. S conveys all the stock of B to Company A; in that year Company A earns net income of $33,000 while Company B sustains a loss (for that year alone) of $12,000, and they elect to file a consolidated return for that year.

These facts are said in the decision below in this proceeding to represent the decision in National Slag Company v. Commissioner (47 Fed. (2d) 846), which, the court below indicates, reaches an equitable result.

The taxable net income upon the consolidated return for 1927 is computed under respondent's method of applying net losses (which is approved by the court below herein) as follows:

Co. A Net Income 1927	$33,000	
Net Loss 1926	(10,000)	
Net Income remaining 1927		$23,000
Co. B Loss 1927 alone	$(12,000)	
Net Loss 1926 ($11,000) not applied		
Ordinary Loss 1927 (alone)		(12,000)
Consolidated Net Income 1927 *return*		$11,000

Here the method of the respondent, approved by the decision below in this cause, would deny deduction for the loss of the subsidiary for 1926 although the court indicates that it considers the result reached (under the taxpayer's method) equitable in that case.

The following result under the taxpayer's method of applying net losses accords with the equities of the continuing interest of Mr. S in the two corporations:

Co. A Net Income 1927	$33,000	
Net Loss 1926	(10,000)	
Net Income remaining 1927		$23,000
Co. B Loss 1927 alone	$(12,000)	
Net Loss 1926	(11,000)	
Ordinary Loss 1927 (Sec. 232)		(23,000)
Consolidated Net Income 1927 *return*		None

This example covers the group of cases in which the continuing interest is the same and in which the companies do not elect to file a consolidated return in one year, but because of a new election or by securing permis-

sion they change to a consolidated return in the next year. Such election to change the basis of reporting (even where no change in stock interest occurred) was given by statute and general regulations in 1922, 1924, 1925, and 1926, (See Article 632, Treasury Regulations 62, 65, and 69 and T. D. 4026, VI-1 C. B. p. 99) and consolidated companies may change in any year from 1922 to 1928 inclusive upon securing permission of the Commissioner of Internal Revenue.

Thus in numerous cases in which the continuing interest is identical in both years the respondent's method of applying net losses does not reach the equitable result. He computes a taxable income of $11,000 on the consolidated return (above) when there were no net earnings of the group. The taxpayer's method on the contrary, accords with the actual and practical results of the operations of the group for the two years, as well as complying specifically with the statute.

Example 7.

The Facts.—Company A owned all the stock of Company B in 1926 and 1927; in the former year Company A earned $1,000 and Company B sustained a net loss of $34,000. In 1927 the parent transfers part of its business to the subsidiary and in that year Company A earns $31,000 and Company B $2,000.

The taxable net income upon the consolidated return for 1927 is computed under the respondent's method (of following the loss through only to each separate company) as follows:

1926—Co. B Net Loss	($34,000)	
Co. A Net Income	1,000	
Consolidated Net Loss 1926 Applicable to Co. B (Sec. 206)		($33,000)
1927—Co. B Net Income	$2,000	
Net Loss from 1926	(33,000)	
Applicable against A	(None)	
Co. A Net Income	$31,000	
Taxable Net Income upon consolidated basis for 1927		$31,000

See G. C. M. 8618 (IX-2 C. B. p. 180) at page 188, last paragraph, the 1926 "net loss may not be used as a deduction in * * * (1927) beyond the point where there is income to the member to absorb it."

Here is a continuing consolidation in which there is no profit for the two years 1926 and 1927 in the aggregate, and yet the respondent would determine a net income of $31,000.

The following result under the taxpayer's proposed method of applying net losses, on the other hand, accords with the actual result of the two years' operations:

1926—Co. B Net Loss	($34,000)	
Co. A Net Income	1,000	
Consolidated Net Loss 1926 Applicable to Co. B (Sec. 206)		($33,000)

1927—Co. B Net Income	$2,000
Net Loss from 1926	(33,000)
Ordinary loss 1927 (Sec. 232)	($31,000)
Applicable against Co. A (Sec. 240)	
Co. A Net Income	31,000
Taxable Net Income upon a consolidated basis for 1927 return	None

In this group will fall the case where the parent in 1927 creates out of whole cloth a new Subsidiary Company C, to which it conveys a part of the parent's business which may earn $21,000 in 1927 and leave the parent with income of $10,000. The true commercial group is not changed; the true total income of the group is not altered, and yet under the respondent's method the application of the 1926 net loss is even more remote. Where he will not apply the loss against the income of the continuing Company A, he certainly will deny it to the new Company C.

In G. C. M. 8618 (IX-2 C. B. p. 180) at the bottom of page 180, it is found that "The assets of the newly incorporated companies were acquired from other companies in the group for which the new companies issued their stock." Despite this fact that the new companies in the group are carrying on part of the business previously done by other members of the roup, the conclusion (in the last paragraph on page 188) is that the prior net losses of the other members may not be applied against the income of the new companies.

Under the taxpayer's method, however, the equitable result is reached under the statute again in this case, as follows:

1926—Co. B Net Loss	($34,000)	
Co. A Net Income	1,000	
Consolidated Net Loss 1926 Applicable to Co. B (Sec. 206)		$(33,000)
1927—Co. B Net Income	$2,000	
Net Loss from 1926	(33,000)	
Ordinary loss 1927 (Sec. 232)	$(31,000)	
Applicable against other Cos. (Sec. 240)		
Co. A Net Income	10,000	
Co. C Net Income	21,000	
Taxable net income upon a consolidated basis for 1927 return		None

In extending his equitable theory the respondent may argue that the loss of a subsidiary may be corrected by transferring more business to it. Yet to obtain the benefit of the net loss provisions (under the respondent's method) the group must nicely balance the profits and losses of the individual companies. Unless the subsidiary earns enough profit in 1927 to absorb its loss for 1926 the respondent would deny a computation which shows the true result of the group. The consolidated group at its peril must rearrange its affairs (irrespective of commercial considerations) so as to equalize the profits and losses of the separate companies if the group is to have the benefit of the actual net losses under the respondent's method.

Business groups are operated for practical purposes and should not be required to juggle their internal affairs to obtain a fair tax benefit. The very purpose of the con-

solidated returns provisions (Section 240) is to prevent, and obviate the necessity for, juggling the accounts of companies in a consolidated group in computing taxable income. The statute intends to impose taxes upon the commercial results of the group as a whole without regard to the details of individual companies.

With this general purpose (in Sec. 240) a contrary intent can hardly exist for the application of Section 206. Yet the respondent's method stops with the application of the 1926 net loss to the individual company in 1927 (under Section 206). The taxpayer's method goes on from that point and (under Section 232) computes an ordinary loss for 1927 which may (under Section 240) be applied against the income of the other companies in the consolidated return. The respondent stops one step short of a true consolidated computation. The taxpayer, more specifically following the statute (Sec. 206, 232 and 240) in his proposal supplies the step necessary to the practical and equitable (as well as statutory) result in the great number of consolidated returns.

V. SUMMARY

We have seen (Examples 1 and 2) that the respondent in the cases of other consolidated groups will follow the statute (Sec. 206), even though it may appear to produce an inequitable result in certain instances. In the Woolford Realty Company matter, however, he proposes a method for applying net losses which ignores the statute (Section 232) merely in order that he may reach an allegedly equitable result.

It is developed herein (Examples 4 to 7) that the respondent's proposal on the contrary works inequity in many large groups of cases. The taxpayer's proposed

computation in the Woolford case, on the other hand, reaches an equitable (and we submit, statutory) result in the application of net losses in the large number of consolidated returns.

We believe it is demonstrated that the respondent's supposed equitable argument is specious, and not supported by the result of the computations in a great number of cases. As a consequence, the respondent's proposed method should be rejected and the taxpayer's method (more specifically following the statute, Sections 206, 232 and 240) should be adapted, irrespective of the apparent equities of any one particular case.

Respectfully submitted,

FREDERICK L. PEARCE
GEORGE M. MORRIS
Amici Curiae

Of Counsel

KIXMILLER, BAAR & MORRIS,
Washington, D. C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1931.

NO. 582.

WOOLFORD REALTY COMPANY, INC., *Petitioner,*

vs.

J. T. ROSE, *Collector of Internal Revenue.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

BRIEF SUBMITTED IN BEHALF OF FEDERAL EXPORT CORPORATION BY *AMICI CURIAE*, WITH MOTION FOR LEAVE TO FILE THE SAME.

LOUIS TITUS,
HENRY M. WARD,
Amici Curiae.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS *AMICI CURIAE.*

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Now come the undersigned counsel for Federal Export Corporation, plaintiff in a cause now pending in the Court of Claims entitled "Federal Export Corporation v. The United States, No. H-106", and, the consent of counsel for both the Petitioner and Respondent having been first

granted, pray for leave to file the attached brief upon the points therein discussed.

LOUIS TITUS,
HENRY M. WARD,
Counsel for
Federal Export Corporation.

April 19th, 1932.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931.

NO. 582.

WOOLFORD REALTY COMPANY, INC.,

vs.

J. T. ROSE, *Collector of Internal Revenue.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

BRIEF

SUBMITTED IN BEHALF OF FEDERAL EXPORT CORPORATION BY *AMICI CURIAE.*

FIRST.

A question is presented in the instant case which is similar to, though not identical with, that presented in the pending suit of Federal Export Corporation in the Court of Claims.

The instant case presents two principal questions; both relating solely to the construction of a tax statute.

(a). Whether with respect to an affiliated group of corporations included in a consolidated return, a loss sustained in 1925 and 1926 by a member of the group can be carried over into 1927, the tax year involved, in which year such member had no taxable income, and so be deducted in computing the consolidated income for that year under Sections 240 and 206 of the Revenue Act of 1926 (Government brief, p. 2).

(b). Whether under Section 206 of the Act of 1926, losses sustained in 1925 and 1926 when such corporation was not affiliated, can be carried over into 1927, when it was affiliated (Ibid).

We have stated the two questions separately because a decision against the petitioner on question (b) might well be held to eliminate question (a). Our client, Federal Export Corporation, is interested only in question (a). The interest arises as follows:

Federal Export Corporation, the parent company, in 1919 filed a consolidated return for the year 1918, embracing a group of seven corporations affiliated in 1918 and constituting mere incorporated branches or divisions of its corporate business organization. Certain of these affiliated corporations sustained net losses, or had small net taxable incomes in 1918. They sustained net losses in 1919 greater than the taxable incomes (if any) for 1918.

The question presented in that case is whether, under Section 204(b) of the Revenue Act of 1918, 40 Stat. 1057, 1061 (quoted in Government brief at p. 33), such losses are allowable as deductions for the affiliated group in 1918.

Thus, while the question is similar to that involved in the instant case, and, as pointed out in the Government's brief (pp. 21-22), has been passed on by the Court of Claims in the *Swift* case (38 Fed. 2d, 365) and by the Cir-

cuit Court of Appeals for the Second Circuit in *Sweets Co. v. Commissioner* (40 Fed. 2d 436), the question in Federal Export case relates to the construction of a highly remedial statute, enacted to relieve taxpayers from losses consequent upon the sudden termination of the World War, so that it is submitted that the decision of point (a) *supra,* (if decision is not eliminated) need not necessarily control the construction of another statute, the terminology of which is distinct.

SECOND.

The questions presented in the instant case, as noted, are solely questions of the construction of a taxing statute.

This court in *Old Colony Railroad Company v. Commissioner,* No. 349, October Term, 1931, decided February 15 1932, has reiterated the settled rule clearly applicable to the instant ease, as follows:

> "If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer. *Gould v. Gould,* 245 U. S. 151; *United States v. Merriam,* 263 U. S. 171; *Bowers v. Lighterage Co.,* 273 U. S. 346; *United States v. Updike,* 281 U. S. 489; *Burnet v. Niagara Falls Brewing Co.,* 282 U. S. 649."

To elucidate the position of the Government in the instant case, stated at page 4, first paragraph of the brief, an argument is made, 25 pages in length (pp. 8-32), all devoted to the *construction* of sub-section (b) of Section 206 of the Act of 1926 (quoted at p. 35) as read *in the light of the provisions* of Sec. 240(a), (quoted pp. 36, 37.) and Sections 232 and 234 (quoted at p. 36).

Full briefs have been filed in behalf of petitioner and by *amici curiae.* We concur in the views expressed in petitioner's brief in support of the petition and brief on argument and in the brief filed by Rollin Browne, Esq.,

as *amicus curaial,* but would only supplement what they have said by the above statement of the settled and applicable rule of construction and by calling attention to an inadvertent statement in the Government's brief.

At page 11, in discussing the question of construction, the applicable rule is stated as follows:

> "If there is any doubt it should be resolved in favor of the normal method of tax computation. 'The intent to exclude must be definitely expressed where—the general language of the Act laying the tax is broad enough to include the subject-matter'. *Choteau v. Burnet,* 283 U. S. 691, 696. See also *Bowers v. Lawyers' Mortgage Co.,* 285 U. S., decided March 14, 1932; *Heiner v. Colonial Trust Co.,* 275 U. S. 232, 235; *Cornell v. Coyne,* 192 U. S. 418, 431; *Swan & Finch Co. v. United States,* 190 U. S. 143, 146; *Bank of Commerce v. Tennessee,* 161 U. S. 134, 146—"

It is submitted that this statement of the rule is tantamount to saying that where the taxpayer claims the right to a deduction under the special consolidated returns section 240 Act of 1926 and the question is whether that section is controlled by the narrow meaning attributed to the word "taxpayer" in another general section (206 (b)), the construction most favorable to the Government should be adopted.

Without burdening the Court with an extended analysis of the cases cited, it is sufficient to refer to them briefly and to point out that the excerpt quoted from *Choteau v. Burnet,* 283 U. S. 691, 696, related, not to the construction of an income tax statute, but to whether the statute which made the Indians "competent" in certain cases (Act of June 28, 1906, c. 3572 34 Stat. 539), operated to exempt royalties derived from oil and gas wells from income taxes imposed on "every individual" upon income "from any source whatever". It was held that the exemption claimed must be clearly stated in the *statute fixing the status of the Indians,* and that this status was defined, not by the

taxing Act, but by the Act which gave the Indians (with immaterial exceptions) the same taxable status as all citizens. A similar question was involved in *Heiner v. Colonial Trust Co.*, 275 U. S. 232.

In *Bowers v. Lawyers' Mortgage Company* (#355, March 14, 1932), the question was not as to the construction of the statute, but

> "whether on the admitted facts respondent was an insurance company subject to the tax imposed by Sec. 246 and therefore not taxable under Sections 230 and 1000".

As in the Indian cases, the question was as to the status of the taxpayer, not as to the construction of provisions of a tax act.

In *Cornell v. Coyne,* 192 U. S. 418, 431, an excise tax was laid on the manufacturer of filled cheese. Cheese under contract for export was manufactured and the tax paid. Recovery was sought on the ground that the tax was levied on "articles exported from a State" in violation of Section 9, Article I of the Constitution. The portion of the opinion cited (O. 431) relates to whether exported cheese was exempt from the tax imposed upon "all filled cheese which shall be manufactured". The Court says (p. 431):

> "Clearly there is nothing in the body of the Act exempting exported filled cheese from the ordinary manufacturing tax on other filled cheese".

The case has no bearing on the settled rule of construction of doubtful provisions in favor of the taxpayer.

In *Swan & Finch Co. v. United States,* 190 U. S. 143, 146, the question was whether certain lubricating oils consumed on a vessel bound to a foreign port were "exported" and so entitled to a drawback of the customs duties paid on importation. At page 146 the opinion reads:

"Where the burden is placed upon a citizen, if there be doubt as to the extent of the burden it is resolved in favor of the citizen, but where a privilege is granted any doubt is resolved in favor of the Government. In *Hartranft v. Weigmann*, 121 U. S. 609, 616, the one rule was thus stated: 'We are of opinion that the decision of the Circuit Court was correct. But if the question were one of doubt, the doubt would be resolved in favor of the importer 'as duties are never imposed on the citizen upon vague or doubtful interpretations'" (citing authorities).

Bank of Commerce v. Tennessee, 161 U. S. 134, 146, had to do with the construction of the charter of a corporation (p. 145). The bank claimed that the provisions of the charter exempted it from liability to certain general taxes. The question as in the Indian cases cited, involved the status of the taxpayer and not the construction of a taxing act.

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It is further submitted that the decisions of this Court in *Bowers v. Lighterage Co.*, 273 U. S. 346; *United States v. Updike*, 281 U. S. 459, and *Russell v. United States*, 278 U. S. 181, lay down a rule of construction even more favorable to the taxpayer than is involved in the instant case. In each of these cases, the question of construction was whether the statute of limitations had run against the United States. It was strongly urged that in view of the settled rule that the United States is never bound by any statute of limitations unless the statute expressly so provides, the question of construction should be resolved against the taxpayer. In each case it was ruled that because the period of limitation was contained in a taxing statute, the broad general rule of construction in favor of the taxpayer must prevail.

April 19, 1932.

LOUIS TITUS,
HENRY M. WARD,
Amici curiae.

SUPREME COURT OF THE UNITED STATES.

No. 582.—October Term, 1931.

Woolford Realty Company, Inc., Petitioner, *vs.* J. T. Rose, Collector of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[May 16, 1932.]

Mr. Justice Cardozo delivered the opinion of the Court.

Petitioner and Piedmont Savings Company are separate corporations organized in Georgia. They became affiliated in 1927 when the petitioner became the owner of 96% of the Piedmont stock. In March, 1928, the two corporations filed a consolidated income tax return for 1927 under section 240 of the Revenue Act of 1926. Revenue Act of 1926, c. 27, 44 Stat. 9, 46. During 1927, the petitioner had a net taxable income of $36,587.62, and Piedmont had suffered during the same year a net loss of $453.80. Before its affiliation with the petitioner, it had suffered other and greater losses. Its net loss in 1925 was $43,478.25 and in 1926 $410.82, a total for the two years of $43,889.07. In the assessment of the tax for 1927, the commissioner deducted from the petitioner's net income for that year the loss of $453.80 suffered by its affiliated corporation in the course of the same year. The consolidated net taxable income as thus adjusted was $36,133.82, on which a tax of $5,026.22 was assessed and paid. On the other hand, the commissioner refused to deduct the Piedmont losses suffered in 1925 and 1926 before the year of affiliation. The deductions, if allowed, would have wiped out the tax. A refund having been refused, the petitioner brought this suit against the Collector to recover the moneys paid. The District Court sustained a demurrer to the petition 44 F. (2d) 856), and the Court of Appeals affirmed. 53 F. (2d) 821. The case is here on certiorari.

Section 240 (a) of the Revenue Act of 1926 provides that "corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regu-

lations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return."

Section 240 (b) provides that "in any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. . . ."

The general principle underlying the income tax statutes ever since the adoption of the Sixteenth Amendment has been the computation of gains and losses on the basis of an annual accounting for the transactions of the year. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363. A taxpayer who seeks an allowance for losses suffered in an earlier year, must be able to point to a specific provision of the statute permitting the deduction, and must bring himself within its terms. Unless he can do this, the operations of the current year must be the measure of his burden.

The only section of the revenue act that made allowance in 1927 for the losses of earlier years was section 206 (b), upon which this controversy hinges. Its provisions are as follows:

"If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Under that section of the statute, the losses suffered by the Piedmont Company in 1925 might have been deducted from its net income in 1926, and might thereafter, if not extinguished, have been deducted to the extent of the excess from its net income in 1927, the year in which its shares were acquired by the petitioner. But the Piedmont Company did not have any net income in 1927.

Its operations for that year resulted in a loss. There was therefore nothing from which earlier losses could be deducted, for the net income without any such deductions was still a minus quantity. The tax for the year was nothing, and the losses of other years could not serve to make it less. The petitioner would have us hold that the minus quantities for all the years should be added together, and the total turned over by the company suffering the loss as an allowance to be made to the company realizing the gain. In that view of the statute, a net loss for a taxable year becomes for the purpose of determining the burdens of affiliated corporations, though not for any other, the equivalent of a net income, and deductions which the statute has said shall be made only from net income, may, none the less, by some process of legerdemain, be subtracted from the loss.

There are two fundamental objections to this method of computation. In the first place, an interpretation of net income by which it is also a net loss involves the reading of the words of the statute in a strained and unnatural sense. The metamorphosis is too great to be viewed without a shock. Certainly the average man suffering a net loss from the operations of his business would learn with surprise that within the meaning of the Congress the amount of his net loss was also the amount of his net income. "The popular or received import of words furnishes the general rule for the interpretation of public laws". *Maillard* v. *Lawrence,* 16 How. 251, 261; *Old Colony R. R.* v. *Commissioner,* 284 U. S. 552, 560. In the second place, the statute has given notice to the taxpayer that the aggregate of minus quantities is not to be turned over as a credit to an affiliated company, but is to be used in another way. If the loss for the first year is more than the income for the second, the excess is to be carried over to a third year, and deducted from the net income, if any, returnable for that year, at which time the process of carrying over is to end. Cf. report of Senate Committee in charge of the revenue act of 1924, Senate Report No. 398, 68th Congress, 1st Session, p. 20. Obviously, the direction to apply the excess against the income of a later year is inconsistent with a purpose to allow it to an affiliated company as an immediate deduction from income of the current year. Adherence to the one practice excludes adherence to the other. Cf. Treasury Regulations 69 promulgated under the act of 1926, Arts. 634, 635, 1622. The fact is not to be ignored that each of two or more cor-

porations joining (under sec. 240) in a consolidated return is none the less a taxpayer. *Commissioner* v. *Ginsburg Co.*, 54 F. (2d) 238, 239. By the express terms of the statute (sec. 240 b) the tax when computed is to be assessed, in the absence of agreement to the contrary, upon the respective affiliated corporations "on the basis of the net income properly assignable to each." "The term 'taxpayer' means any person subject to a tax imposed by this Act." Revenue Act of 1922, sec. 2a (9). A corporation does not cease to be such a person by affiliating with another.

The petitioner insists that a construction of 206 (b), excluding the allowance of past losses except as a set-off against the income of the company sustaining them is inconsistent with the accepted construction of section 234 of the same act whereby the deductions there enumerated are made from the net income exhibited by the consolidated return without reference to their origin in the business of one company or another. Section 234 provides that in computing the net income of corporations subject to a tax there shall be allowed as deductions "(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . . (2d) All interest paid or accrued within the taxable year on its indebtedness . . . ; (3) Taxes paid or accrued within the taxable year . . . .; (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. . . . . ; (5) Debts ascertained to be worthless and charged off within the taxable year." The points of difference between the allowances under section 206 (b) upon the one hand and those under section 234 upon the other are important and obvious. The deductions allowable under section 234 represent expenses paid or accrued or losses suffered during the same taxable year covered by the return. They are thus included in the net income according to the fundamental concept of such income reflected in the statute, instead of falling within an exception which, irrespective of its precise extension, is a departure from the general scheme. Even more decisive is the consideration that there is nothing in section 234 prohibiting the allowance by one unit of its current losses and expenses as a deduction for the benefit of the affiliated group, nor any statement that the use to be made of them shall follow other lines. On the other hand, section 206 (b) provides, as we have seen, that the excess of loss remaining over the current net income of the taxpayer who has

suffered it shall be carried over into the next year and if need be into a third, and thereafter disregarded. Subtle arguments have been addressed to us in support of the contention that the loss of one affiliated company suffered in earlier years may be allocated to the other without infraction of the rule that the loss shall be carried forward. They are not lacking in plausibility, but we cannot hold that they comport with the directions of the statute "if we take words in their plain popular meaning as they should be taken here." *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, 3.

Doubt, if there can be any, is not likely to survive a consideration of the mischiefs certain to be engendered by any other ruling. A different ruling would mean that a prosperous corporation could buy the shares of one that had suffered heavy losses and wipe out thereby its own liability for taxes. The mind rebels against the notion that Congress in permitting a consolidated return was willing to foster an opportunity for juggling so facile and so obvious. Submission to such mischiefs would be necessary if the statute were so plain in permitting the deduction as to leave no room for choice between that construction and another. Expediency may tip the scales when arguments are nicely balanced. True, of course, it is that in a system of taxation so intricate and vast as ours there are many other loopholes unsuspected by the framers of the statute, many other devices whereby burdens can be lowered. This is no reason, however, for augmenting them needlessly by the addition of another. The petitioner was prosperous in 1927, and so far as the record shows for many years before. Piedmont was unfortunate in 1927, and unfortunate in the years preceding. The petitioner, affiliating in 1927, has been allowed the loss suffered by Piedmont though the business of that year as a permissible deduction from the consolidated balance. What it claims is a right to deduct the losses that were suffered in earlier years when the companies were separate. To such an attempt the reaction of an impartial mind is little short of instinctive that the deduction is unreasonable and cannot have been intended by the framers of the statute. Analysis of the sections shows that there is no gap between what they wrote and what in reason they must have meant.

The petitioner refers us to the Revenue Act of 1928 (45 Stat. 791, 835) and to Treasury Regulations adopted thereunder as sup-

porting its position. These provisions were adopted after the liability for the tax of 1927 had accrued, and they can have little bearing upon the meaning to be given to statutes then in force. The Revenue Act of 1928 (sec. 141b) protects against unfair evasions in the making of consolidated returns by increasing the discretionary power of the Commissioner in prescribing regulations. "The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability." Under the authority so conferred the Commissioner has adopted the following regulation (Treasury Regulations 75, art. 41), applicable only to the taxable year 1929, and to taxable years thereafter:

"A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

The provision in this regulation limiting the deductions to the cost or value of the stock will make it profitless hereafter to purchase stock for the purpose of gaining the benefit of deductions in excess of what is paid.

In holding that the Piedmont losses of 1925 and 1926 were properly excluded from the consolidated return, we are in accord with the preponderance of authority in the other federal courts. *Swift & Co.* v. *United States,* 38 F. (2d) 365; *Sweets & Co.* v. *Commissioner,* 40 F. (2d) 436; *Commissioner* v. *Ginsburg,* 54 F. (2d) 238. Only one decision has been cited to us as favoring a different view. *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846.

The judgment is affirmed.